OFFICIAL TRANSCRIPT OF PROCEEDINGS BEFORE THE POSTAL RATE COMMISSION

In the Matter of:	)	
	)	
REQUEST OF THE	)	
UNITED STATES POSTAL SERVICE	)	
FOR A RECOMMENDED DECISION	)	Docket No. R2005-1
ON CHANGES IN RATES OF	)	
POSTAGE AND FEES FOR	)	
POSTAL SERVICES	)	

VOLUME #10

Date: September 14, 2005

Place: Washington, D.C.

Pages: 5716 through 5926

HERITAGE REPORTING CORPORATION
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POSTAL RATE COMMISSION

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Room 200
Postal Rate Commission
901 New York Avenue, N.W.
Washington, D.C.

Volume 10
Wednesday, September 14, 2005

The above-entitled matter came on for hearing pursuant to notice, at 9:35 a.m.

BEFORE:

HON. GEORGE A. OMAS, CHAIRMAN
HON. TONY A. HAMMOND, VICE CHAIRMAN
HON. RUTH Y. GOLDWAY, COMMISSIONER
HON. DANA B. COVINGTON, COMMISSIONER
HON. DAWN A. TISDALE, COMMISSIONER

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C O N T E N T S

WITNESSES APPEARING:
ANTOINETTE CROWDER
GODFREY OTUTEYE

E X H I B I T S

P R O C E E D I N G S

(9:35 a.m.)

CHAIRMAN OMAS: Good morning and welcome to 901 New York Avenue and the Commission's new digs, I guess you would call it. As you can see, we're still completing construction. Hopefully, all of our electronics are in proper working order, but if we do experience some initial problems, I ask that you all please bear with us, and Commissioner Hammond has accepted to take over the role of the chair in case I lose my voice in trying to communicate with you.

When construction is finally completed, the Commission will sponsor an open house and will invite everyone to inspect our new space. In the interim, please limit the amount of exploring you do, as construction is still continuing. For your information, restrooms are on the other side of the entrance lobby to your right. The parking garage is open until 7 o'clock at night. However, it is my understanding that if you have a credit card to pay the parking fee, you can exit even after the garage is closed.

On days when there is a hearing or other public events at the Commission, you will be able to access our offices without assistance. However, on

days when there is no public proceeding, access to the Commission offices will be restricted for security purposes. The concierge desk in the building lobby will happily help you get access to our offices. They will also assist you if you have any other problems relating to the new building.

Today, we begin our final set of hearings in Docket R-2005-1. Today and tomorrow, we will hear testimony in rebuttal to the participants' direct testimony. Two witnesses are scheduled to appear today: Antoinette Crowder and Godfrey Otuteye.

Does anyone have any procedural matters to discuss before we begin?

(No response.)

CHAIRMAN OMAS: Mr. McLaughlin, would you please identify your first witness so I can swear her in?

MR. McLAUGHLIN: Mr. Chairman, we call Antoinette Crowder.

CHAIRMAN OMAS: Ms. Crowder, would you please stand?

Whereupon,

ANTOINETTE CROWDER

having been duly sworn, was called as a witness and was examined and testified as follows:

CHAIRMAN OMAS: You may be seated.

(The document referred to was marked for identification as Exhibit No. ADVO-RT-1.)

DIRECT EXAMINATION

BY MR. McLAUGHLIN:

Q Ms. Crowder, I'm showing you two copies of a document captioned ADVO-RT-1, "Rebuttal Testimony of Antoinette Crowder on behalf of Advo, Inc." Was this testimony prepared by you or under your direction or supervision?

A Yes, it was.

Q And do you sponsor it?

A Yes, I do.

Q Do you have any editorial corrections to make to your testimony?

A Yeah. There are four editorial corrections. The first is on page 15, and that would be at line 2, and the sentence that begins, "Because the different markets for," should read, "Because different markets for these products...."

Page 17, line 10, there should be, before the words "high density," there just should be the word "the."

On page 26, it's footnote 16, and there is a

line that begins with the number 22, and it should read: "Does not apply when the tester finds nonidentical or mixed mail," and here is the insert, "not subject to the top piece rule."

And the last is on page 39, line 14, and that should read: "Lower saturation letter rate" instead of "cost."

MR. McLAUGHLIN: Mr. Chairman, these corrections have been made in the record copies that we're going to provide.

BY MR. McLAUGHLIN:

Q With those corrections, is this testimony true and correct, to the best of your information and belief?

A Yes, it is.

Q And would your testimony be the same today if you were testifying orally?

A Yes, sir.

MR. McLAUGHLIN: Mr. Chairman, I would move that ADVO-RT-1 be received into evidence and transcribed into the record, and I'll be providing the reporter with two copies.

CHAIRMAN OMAS: Is there any objection?

(No response.)

CHAIRMAN OMAS: Hearing none, I will direct

counsel to provide the reporter with two copies of the corrected direct testimony of Antoinette Crowder. That testimony is received into evidence and is to be transcribed into the record.

(The document referred to, previously identified as Exhibit No. ADVO-RT-1 was received in evidence.)

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Postal Rate Commission
Submitted 9/8/2005 3:22 pm
Filing ID: 46692
Accepted 9/8/2005
ADVO-RT-1

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

POSTAL RATE AND FEE CHANGES PURSUANT TO PUBLIC LAW 108-18	:	**Docket No. R2005-1**

REBUTTAL TESTIMONY

OF

ANTOINETTE CROWDER

ON BEHALF OF

ADVO, INC.

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September 8, 2005

CONTENTS

I. INTRODUCTION, PURPOSE, AND SUMMARY

A. Purpose and Summary

The purpose of this testimony is to provide evidence that rebuts the direct testimonies of Valpak witnesses Robert Mitchell (VP-T-1) and John Haldi (VP-T-2). In their direct testimonies, Mr. Mitchell and Dr. Haldi fixate on one element of the ECR rate structure – the letter-flat rate differential. Mr. Mitchell contends that the Postal Service's proposed ECR letter-flat rate differentials are too low and should be increased, even to the point of applying a "cost coverage" markup well above 100 percent of the letter-flat cost differential. Mr. Mitchell's arguments reflect fundamental misunderstandings of (1) the nature of the letter-flat cost differential, and (2) the proper relationship of the letter-flat rate differential to the ECR pound rate in setting appropriate and rational ECR rates. Dr. Haldi offers multiple arguments why he believes the Saturation letter cost is overstated relative to that of Saturation flats. In one case, he correctly identifies an understatement of detached address labels in the USPS analysis. But in all others, his testimony on these issues is unsupported, misleading, and wrong.

The USPS-Proposed Letter-Flat Rate Differentials Should Not be Increased

Mr. Mitchell recommends that the Commission consider expanding the ECR letter-flat piece rate differentials so they equal at least 100 percent of their respective cost differentials. At the Basic-Rate level, he also recommends that the rate differential should equal the cost differential marked-up by the ECR subclass mark-up percentage. His rationale for this latter is that ECR letters and flats should be treated as two different products with equal cost coverages.

Whether he treats ECR letters and flats as simply workshared variants of the same ECR product or he treats them as completely different products, he is wrong. With respect to treating them as workshared variants of one ECR product, he simply misses the fact – acknowledged by the Commission in Docket R2000-1 and by Valpak-Carol Wright witness Haldi in R97-1 – that the letter-flat cost differential reflects not just shape-related cost differences but also weight-related cost differences due to the heavier average weight of flats versus letters. In R2000-1, the Commission stated,

> "As the pound rate is supposed to reflect the effect of weight on costs, passing through a substantial portion of the ECR letter/flat differential amounts to a double counting of the effect of weight." R2001-1 PRC Opinion 2000-1 at 365.

On this basis alone, Mr. Mitchell's proposal to pass through "at least 100 percent" of the letter-flat cost differential is wrong. Given the ECR pound rate, the letter-flat passthrough must be set at a level significantly below 100 percent to avoid double-charging flat mailers for weight. Alternatively, if the passthrough and resulting letter-flat rate differential were to be increased above the level proposed by the USPS (as Valpak argues), then the pound rate must be reduced correspondingly.

With respect to treating letters and flats as different products, Mr. Mitchell misconstrues the nature of product pricing. He claims that ECR letters and flats are two different products and advocates that the passthrough of the letter-flat cost differential should be "marked up" above 100 percent, so that it will equalize contribution from letters and flats (page 83). But, that is wrong, both in concept and execution.

The true comparison of product cost coverages requires a comparison of *total* (non-workshare-adjusted) costs and *total* revenues. Mr. Mitchell's comparison, by contrast, looks at a workshare-adjusted letter-flat cost differential. And passthroughs of that cost differential mean passthroughs only to the piece rate cost differential, ignoring the fact that the pound rate is intended to cover weight-related costs. In essence, his approach would over-recover weight-related costs in both the flat piece rate and in the pound rate.

Mr. Mitchell does have a point that letters and flats can be viewed as separate products, particularly with respect to Saturation/High-Density mail that meets Commission's requirements as a separate product. But, at the Postal Service's proposed rates, the Saturation/High-Density flat product has a higher cost coverage than the Saturation/High-Density letter product.

USPS Version of TY06 Product Costs

	TY Unit Cost	TYAR Unit Revenue	TYAR % Coverage
High-Density/ Saturation Letters	4.653¢	13.630¢	292.9%
High-Density/ Saturation Flats	4.961	16.144	325.4%

Note: These costs reflect the revised DAL volumes.

There are two reasons for this higher cost coverage for High-Density/Saturation flats: (1) they are drop-shipped deeper into the postal system than are comparable letters and (2) their revenues are derived from both a piece and a pound rate where both rates cover some of the same weight-related cost reflected in the letter-flat cost differential.

In sum, a less-than-100-percent letter-flat passthrough is not a problem and, as products, High-Density/Saturation flats are not undercharged relative to

High-Density/Saturation letters. There is no need to passthrough any more of the High-Density/Saturation letter-flat cost differential than already proposed by the USPS. However, if the Commission chooses to increase the letter-flat rate differential, it should concomitantly reduce the ECR pound rate.

The Revised DAL Estimates Provide No Excuse to Change USPS-Proposed ECR Saturation Rates

Dr. Haldi, based on data provided by ADVO, has noted that the number of detached address labels estimated by the USPS in its delivery cost analysis was understated. In this testimony, I provide the corrected USPS- and PRC-version delivery cost estimates based on Dr. Haldi's proposed adjustment. The corrected costs do not support an increase in the Saturation letter-flat rate differential and do not change the fact that the High-Density/Saturation flat product makes a greater percentage contribution than does the High-Density/Saturation letter product.

Dr. Haldi's Implication that Saturation Letter Costs Are Excessive Compared to Saturation Flat Costs is Unsupported

Implying that the letter costs are overstated and flat costs are understated, Dr. Haldi makes some interesting but misleading comments on the development of Saturation letter and flat costs. First, because of the way USPS witness Kelley developed the distribution key for city carrier sequenced delivery cost, Dr. Haldi claims that Saturation flats are attributed too little city carrier delivery cost, relative to Saturation letters. However, his analysis of the situation was not taken to its ultimate conclusion. When that is done, the opposite conclusion is reached

– that Saturation flats are attributed too much city carrier delivery cost relative to Saturation letters.

Second, Dr. Haldi asserts that mail processing costs to process some "unknown, but possibly large and growing, volume of DAL [that] are being attributed to letters." (page 21) This is completely untrue. ADVO data, supplied to Valpak, indicate that DALs are not automation compatible. There are also other operational reasons why DALs are not processed at mail processing plants. Further, the USPS data provided in response to Valpak discovery requests also indicates that DAL costs are attributed to their host flats or parcels.

Third, Dr. Haldi describes various postal cost data problems he believes cause letters (defined as letter-shapes 3.5 ounces or less) to bear too much cost. However, what he considers "mismatches" are really part of a proper methodology for matching up operational volumes with operational costs. Although there is some minor imprecision in some of the data, there is no discernable bias. There is no evidence of cost bias against Saturation letters but some evidence that Saturation flats bear too much cost.

Dr. Haldi's Capacity Constraint Theory Does Not Describe the Real World And His Modeled Delivery Costs Are Unnecessary

Dr. Haldi also introduces a novel new theory in this case. It relates to the fact that city carriers can avoid cost by taking out Saturation mailings (without first casing them) as extra bundles or extra trays. Because of the cost avoidance, those mailings are lower cost than mailings that must be cased. He explains, though, that there is a limit to the number of extra bundles and extra trays city carriers may take out. And he implies that the carriers are extremely close to

their limit and that they reserve their remaining capacity for Saturation flats to the harm of Saturation letters. Because of this, he implies that the Saturation letter and flat marginal city delivery costs should be based on cased delivery costs rather than extra-bundle/tray delivery costs. He therefore proposes the use of modeled Saturation letter and Saturation flat cased delivery costs to determine the Saturation letter-flat cost and rate differential.

Dr. Haldi's theory is completely off base: (1) he ignores the fact that city carriers have a variety of ways to expand their extra-bundle/tray capacity, (2) he does not review available evidence on the subject, (3) he ignores any other reasons why some Saturation mail is not handled as extra-bundles/trays, and (4) he ignores the fact that the USPS cost data already reflect conditions where some Saturation mail is DPSed or cased rather than treated as extra-bundles/trays. Data from the new City Carrier Street Time Survey (CCSTS) confirm the fact that city carriers have capacity to handle new Saturation mailings as extra-bundles/trays. Other information also supports that view and explains why many Saturation letters are either DPSed or cased in lieu of being taken out as an extra-bundle or tray.

Finally, Dr. Haldi's proposed modeled delivery cost assumes that there is no city carrier capacity *ever* to handle a new (marginal) Saturation mailing as an extra-bundle/tray. This is so far from the truth that he cannot bring himself to support that assumption (response to ADVO/VP-T2-24). His theory and proposed modeled costs should be rejected.

B. Organization of the Remainder of this Rebuttal Testimony

The remainder of this testimony is organized into three parts. The first addresses rate structure issues presented by Mr. Mitchell and explains them in their proper context. The second part discusses some cost issues noted by Dr. Haldi and explains why they should not have any impact on the rates proposed by the USPS in this case. And, the final part explains why Dr. Haldi's radical capacity constraint theory is wrong and his letter-flat cost proposal is unnecessary.

Workpapers supporting the results presented in this rebuttal are included in ADVO LR-1 (excel spreadsheets) and LR-2 (SAS program and output).

II. VP WITNESS MITCHELL'S RATE STRUCTURE PROPOSAL IS INCONSISTENT WITH SOUND RATEMAKING PRINCIPLES

Much of Mr. Mitchell's testimony (pages 37 through 76) addresses the need to reduce ECR cost coverage. Specifically at page 80 he recommends:

(1) A reduction of 10 percentage points in the ECR cost coverage relative to the coverage proposed by the USPS and 10 additional points of coverage in each of the next two cases; and

(2) ECR rates that remain unchanged from current levels.

However, despite his recommendation to leave ECR rates unchanged, Mr. Mitchell also comments on ECR rate structure issues (pages 81-88). In particular, he discusses the ECR letter-flat rate differentials, contending that 100 percent or even substantially more of the letter-flat cost differentials should be passed through to the relevant rate differentials. He believes that ECR letters and ECR flats are different products whose individual costs need to be recognized and for which individual cost coverages need to be selected (page 83). Mr. Mitchell claims that, if the passthroughs are less than 100 percent, then ECR letter cost coverages are excessive compared to ECR flat cost coverages (page 84).

Mr. Mitchell's passthrough treatment is not only incorrect but incorrectly mixes ratemaking concepts. "Passthroughs" are used in conventional ratemaking where all rate categories within a subclass are considered to be worksharing variants of the same basic product. Differences between rate elements (e.g., the letter and flat piece rates) are based on their worksharing cost differences. When passthroughs are 100 percent, the unit contribution should be the same for each rate category. However, to determine the cost coverages for different *products*, a set of costs different from those used in the conventional approach must be used, together with total product revenues. The correct

treatment of products provides a completely different and more efficient result than that proposed by Mr. Mitchell.

To demonstrate this, I first explain the conventional ratemaking treatment and then explain the correct ratemaking treatment for two different products: ECR High-Density/Saturation Flats and ECR High-Density/Saturation Letters. The quantitative results I present demonstrate that, even at the Postal Service's proposed rates, High-Density/Saturation Flats provide a greater institutional cost coverage than High-Density/Saturation Letters and that expanding the rate differential between them, as Mr. Mitchell advocates, would only exacerbate the disparity.

A. Conventional ECR Cost and Rate Treatment

(1) Conventional Treatment of ECR Rate Categories

Because all ECR rate categories are in the same subclass, postal ratemaking conventionally considers them as worksharing variants of one product. Thus, all the category costs are adjusted so that they reflect worksharing-related differences. Under that convention, passthroughs of no more than 100 percent of cost differentials are applied (with some minor exceptions) to piece rate differentials. This treatment is appropriate when the cost difference between two rate categories is considered only the result of worksharing. The intent is to ensure that (a) all rate categories generate the same institutional cost contribution and (b) mailers have the correct price signals so that they may efficiently choose from among the product variants.

(2) Letter-Flat Cost Differences Reflect Both Shape and Weight-Related Cost Differences

ECR letter and flat unit costs include all costs caused by all their individual characteristics – including shape- or piece-related and weight-related costs. Despite this fact, the cost differentials between those unit costs are used to determine the supposedly piece-related rate differentials between the letter and flat piece rates for each density level. Because weight-related costs are recovered separately through the pound rate, the weight-related portion of costs captured in the letter-flat unit cost differential must be excluded when setting the letter-flat rate differential. Stated another way, a 100 percent passthrough of both the shape-related and weight-related unit cost differential, as Mitchell advocates, is excessive. Charging flats with a 100 percent passthrough of the letter-flat cost differential plus the pound rate would produce a clearly improper double-counting of weight-related flat costs. This fact was recognized by the Commission in Docket R200-1 and used to support a reduction in the ECR pound rate in that case:

> "[5461] The Commission finds that several considerations, not directly related to the study, point to the appropriateness of a modest reduction in the ECR pound rate. [footnote deleted] These include (1) the demonstration that the current pound rate produces an illogical postage result, inconsistent with notions of fairness and equity and efficient postal operations; (2) the recognition that reclassification has reduced the need for the pound rate to act as a proxy; and (3) the demonstration that the pound rate "over recovers" due to shape. The first two points are largely self-evident; with the respect to the latter point, the Commission notes that witness Crowder's contention that the ECR letter/flat cost differential reflects differences due to shape and weight has merit." R2001-1 PRC Opinion 2000-1 at 365

The Commission further stated:

> "However, because the weight of letters and flats varies, the letter/flat cost differential by density level likely reflects differences in both weight and shape. As the pound rate is supposed to reflect

the effect of weight on cost, passing through a substantial portion of the ECR letter/flat differential amounts to a double counting of the effect of weight." Id., page 365.

Indeed, even Dr. Haldi in R97-1 presented testimony that recognized the letter-flat cost differential included both shape- and weigh-related costs and he, therefore, made allowances for it in his ECR rate structure proposal (Tr. 27/15055-56). Despite this, Mr. Mitchell did not address this inherent and accepted characteristic of the letter-flat cost differential. At the hearing, he was apparently unaware of the issue. (Tr. 9/5417-20) Yet the inclusion of weight-related costs in the letter-flat cost differential is, standing alone, sufficient reason to reject his proposal for a full passthrough.

(3) In Conventional Ratemaking, the Letter-Flat Passthroughs Must Be Far Less Than 100 Percent to Avoid Double-Charging

For the above reasons, the passthrough of the letter-flat cost differential must be substantially less than 100 percent to avoid double-charging for weight-related costs. In this section, I calculate the actual passthroughs at the Postal Service's proposed rates, using revised cost estimates under the USPS and PRC versions of delivery costs that take into account revised estimates of the number of detached address labels (DALs) in the system.[1] From that information plus other information

[1] Development of these costs as well as all the other estimates and calculations described in this text are explained in ADVO LR-1. The revised number of DALs and their treatment is as proposed in ADVO/VP-T2-2 with the exception that the DAL volume distribution between city and rural routes is the actual for the ADVO-reported DAL volumes. In the PRC version, an adjustment was also made to distribute the DAL-related costs only to Saturation flats and to correct for the erroneous rural "crosswalk."

provided by the USPS in its library references, I have calculated the USPS- and PRC-versions of ECR delivery plus mail processing costs by density-level and shape as set forth in the following tables.

USPS Version of TY 06 ECR Category Costs

	USPS Adj MP LR K-84	USPS Delivery LR K-67	Total Ratemaking Costs
Letters			
Automation	1.457¢	2.887¢	4.344¢
Basic	3.776	5.334	9.110
High Density	0.967	4.476	5.443
Saturation	0.967	3.629	4.596
Flats			
Basic	2.889	6.143	9.032
High Density	1.225	4.609	5.834
Saturation	1.225	4.358	5.583

This table shows that under the USPS version of costs, because of the revised DAL estimate, Saturation flat delivery cost is higher and Saturation letter cost is lower than the Postal Service estimate. Even with this change, however, the Saturation level letter-flat rate differential of 0.9-cent is 91.2 percent of the 0.987-cent cost differential. This is an excessively high passthrough given that only 65.6 percent of Saturation flat TYAR revenue is from pieces (i.e., given the implicit ratemaking assumption that 65.6 percent of Saturation flat cost is shape-related).

For the PRC version of costs, the passthrough of the Saturation level letter-flat rate difference is 60.7 percent of the 1.483-cent cost difference, a passthrough quite close to the 65.6 percent of revenue that is piece-related.[2]

[2] In R2001, the PRC approved a 0.8-cent saturation ECR saturation letter-flat rate differential based upon a 1.182-cent cost differential, which represented a passthrough of roughly 68%, quite close to the proportion of Saturation flat piece-rate revenue.

PRC Version of TY06 ECR Category Costs

	USPS Adj MP K-107	USPS Delivery PRC Vers Est	Total Ratemaking Costs
Letters			
Automation	1.523¢	3.579¢	5.102¢
Basic	3.431	5.584	9.014
HD	1.056	4.064	5.121
Sat	1.056	3.808	4.864
Flats			
Basic	3.115	6.509	9.624
HD	1.466	4.755	6.221
Sat	1.466	4.880	6.347

The results presented above show that there is no reason to increase the letter-flat differential at the Saturation level and, in the case of the USPS version, *even provide a reason to reduce it. Conversely, if the* piece rate differential is increased, then the pound rate should be reduced.

B. Appropriate Treatment of Product Costs and Rates

Mr. Mitchell argues that ECR letters and flats are "to a considerable extent" different products and should be priced as different products, each bearing its own costs and meeting its specified institutional cost coverages (pages 82-84 and in response to several interrogatories). To achieve this, he proposes a Basic-Rate letter-flat passthrough percentage that equals the ECR coverage percentage. For all other rate levels, he proposes to increase the passthroughs to 100 percent. Then he apparently proposes to apply the conventional ECR ratemaking algorithm to determine all category piece and pound rates for both products. Apparently he believes that if this is done, it will

ensure that ECR letters, as an individual product, will have a contribution equal to ECR flats, as an individual product.[3]

Mr. Mitchell's discussion wrongly mixes the conventional rate-design concepts as described above with concepts far more appropriate for separate product costing. If the objective is to design efficient product rates for ECR mail, *one must (1) identify the distinguishable ECR "products" and (2) calculate the* total costs for those products. Differences in worksharing cost features should not be neutralized, as done in the conventional rate-design approach. Thus, trying to efficiently price two or more products by manipulating multiple cost passthroughs within the current ECR subclass structure (using workshare-adjusted costs), as proposed by Mr. Mitchell, is extremely awkward if not impossible. It will not generate the efficient rates that Mr. Mitchell professes to desire.

For true product pricing, a different approach must be used that, as described below, first identifies the real "products" that are included in the ECR subclass and then estimates their respective costs, revenues, and contribution percentages.

(1) Identification of Products

Mr. Mitchell's discussion leaves one with the impression that there are only two ECR products: letters and flats. That is not correct. Shape is not the only determinant of product distinctions. Market and operational characteristics are important determinants in identifying different products.

[3] VP-T-1, pages 81-83 and 87 and responses to ADVO/VP-T1-3 and –8.

Revised

For ECR flats, there are clearly two separate markets: (1) Basic-Rate flats and (2) High-Density and Saturation flats. Because ~~the~~ different markets for these products dictate different mailing needs, these two flat products have different mail and postal cost characteristics and they are very likely to have different own-price sensitivities and differences in income and cross-price sensitivities. If, as Mr. Mitchell believes, the costs for each product should be separately identified and marked-up, then, for flats, this should apply to two separate products: Basic-Rate and High-Density/Saturation flats. The same is likely true for ECR letters.

In fact, the High-Density/Saturation product is consistent with the Commission's requirements for determining separate subclass treatment (i.e., separately determined coverage on total product cost). Those requirements specify that the product must have market, mail, and cost characteristics that are distinguishable from those of other products.[4] When that occurs, the subclass for that product will have unique criteria that minimize undesirable crossovers by other products that may cause undesirable product cost and contribution changes.[5] Establishing subclass treatment for such distinguishable products is the best way to ensure efficient rate recognition of total product costs, market characteristics, and mark-up considerations.

For purposes of addressing Mr. Mitchell's comments concerning product costs and cost coverages, I accept his comments that letters and flats are

[4] See, e.g., Commission Opinion in R87-1, paragraphs 5505 ff (pages 581 ff) and MC-95-1, paragraphs 1004 ff (pages I-2 ff).

[5] An undesirable cross-over occurs when mail from one subclass shifts to another in order to take advantage of lower price but that mail does not change its cost or market characteristics. Such shifts could affect the subclass cost and price sensitivity characteristics upon which subclass mark-up is based. Unique subclass criteria define the type of product included in the subclass to the exclusion of all other types of products that could change subclass cost and contribution.

different products and treat High-Density/Saturation flats as a product that is different from High-Density/Saturation letters.

(2) Appropriate Product Costs

In conventional ECR rate design, the actual unit mail processing costs (derived from the IOCS distribution) for the various ECR letter and flat categories are adjusted so that they all represent mail processing cost with zero drop-shipment – thus neutralizing the cost effect of differences in drop-shipment levels. So, despite the fact that Saturation flats actually have a lower unit mail processing cost because of their greater drop-shipment compared to Saturation letters, the "drop-shipment" adjustment has the effect of making the adjusted flat mail processing unit cost greater than that for letters. This conventional treatment is appropriate if one is attempting to price all ECR shape and density rate categories as if they are simply workshare variations of one product. But it is not appropriate when attempting to determine prices for different products within ECR, each assessed on the basis of its individual cost coverage level, as envisioned by Mr. Mitchell.

(3) The High-Density/Saturation Flat Product Has a Larger Percentage Coverage Than the High-Density/Saturation Letter Product

I have estimated the USPS- and PRC-versions of unit product costs for the two products identified above: High-Density and Saturation Flats and High-Density and Saturation Letters. The costs for these two products include the estimated actual mail processing, transportation, and delivery costs (with piggybacks) and are divided by the sum of their corresponding RPW volumes.

Revised

These are compared to the USPS estimate of ECR High-Density and Saturation letter and flat (commercial) revenues under current and proposed rates in order to determine their respective cost coverages.

The results are as follows:

USPS Version of TY06 Product Costs[6]

	TY Unit Cost	TYAR Unit Revenue	TYAR % Coverage
High-Density/ Saturation Letters	4.653¢	13.630¢	292.9%
High-Density/ Saturation Flats	4.961	16.144	325.4%

PRC Version of TY06 Product Costs[7]

	TY Unit Cost	TYAR Unit Revenue	TYAR % Coverage
High-Density/ Saturation Letters	4.818¢	13.630¢	282.9%
High- Density/ Saturation Flats	5.558	16.144	290.4%

It is clear from these results that the High-Density/Saturation flat product has a greater markup than does the High-Density/Saturation letter product.

[6] Total unit cost is the sum of unit mail processing cost from LR K-84, unit transportation cost from LR K-84 (with exception that dropship-avoided mail processing costs from LR K-88 were replaced with caused transportation costs), and unit delivery cost from LR K-67, adjusted for Valpak's estimate of DALs. Revenues are for commercial ECR High-Density and Saturation categories from LR K-115 and letter revenues include the revenues from so-called heavy letters. See ADVO LR-1.

[7] Total unit cost is the sum of unit mail processing cost from LR K-107, unit transportation cost from LR K-107 (with exception that dropship-avoided mail processing costs from LR K-112 were replaced with caused transportation costs), and unit delivery cost from a combination of rural costs from LR K-67 and city costs from LR K-101, adjusted for Valpak's estimate of DALs, with all DAL costs attributed to Saturation flats. Revenues are for commercial ECR High-Density and Saturation categories from LR K-115 and letter revenues include the revenues from so-called heavy letters. See ADVO LR-1.

C. Summary: There Is No Support For Expanding the Letter-Flat Rate Differential

In summary, Mr. Mitchell's concern in this case about equalizing the percentage contribution of separate letter and flat products is unwarranted in the case of High-Density/Saturation mail. Under the conventional ratemaking approach where letters and flats are considered variants of the same product, the letter-flat cost differential reflects both shape-related and weight-related cost differences. Only the shape-related cost differences, which are something less than 100 percent of the total differential, should be "passed-through" to piece rates. The weight-related cost differences are covered in the pound rate. Thus, the High-Density/Saturation letter-flat cost differential passthroughs to rate differentials are appropriately less than 100 percent. If the USPS-proposed High-Density/Saturation letter-flat rate differentials are increased, then a concomitant decrease in the pound rate is required in order to prevent High-Density/Saturation flats from being over-priced relative to letters.

Separately, when properly treated as individual products, High-Density/Saturation flats are shown to have a higher cost coverage than High-Density/Saturation letters at the USPS-proposed rates. Thus, Mr. Mitchell's proposal to equalize product cost coverages through manipulating the letter-flat cost passthrough and rate differential is completely unnecessary. Moreover, his proposed method of "equalizing" product coverages will not accomplish the result he claims but will instead produce excessive flats coverage relative to letters in part because of the double-recovery of weight-related costs in both the piece and pound rates.

Accordingly, Mr. Mitchell's recommendations regarding expanding the *ECR letter-flat rate differentials should be ignored as both uninformed and* causing even more inefficient rates than are now proposed.

III. VP WITNESS HALDI'S COSTING ARGUMENTS DO NOT SUPPORT A AN EXPANDED LETTER-FLAT RATE DIFFERENTIAL

Dr. Haldi makes a number of observations concerning what he considers to be problems with postal cost data and costing studies. These relate to (1) the detached address labels (DALs) that accompany some Saturation flats and some parcels and (2) the fact that Saturation "letters" for rate category purposes weigh 3.5 ounces or less while the postal costing systems identify "letters" as all letter-shapes (even those that weigh more than 3.5 ounces). With respect to the first, he implies that Saturation letter costs may be overstated due to the presence of DALs. With respect to the second, he states that these ". . . other possible inconsistencies and recording errors . . . may have mis-attributed costs systematically to Saturation letters instead of flats." (page 25) As discussed below, now that the delivery costs are adjusted to reflect the revised number of DALs, there is no evidence that Saturation letter costs are overstated relative to Saturation flat costs.

On the other hand, he also urges the Postal Service to improve the way in which its data systems collect volume and cost data on DALs. And, I agree with him on the need for improved data.

In the following three subsections, I discuss (1) the impact of DALs on City Carrier Costing, (2) Dr. Haldi's concern about DAL automation costs being attributed to Saturation letters, and (3) Dr. Haldi's concern about the definition of "letters" in the USPS cost analyses. None of his concerns warrant an expansion of the letter-flat rate differential and one strongly argues for the reverse.

A. The Impact of DALs on City Carrier Casing Reduces Flat Costs More than Letter Costs

Dr. Haldi correctly identifies a problem associated with the impact of DALs on the estimate of cased and sequenced (non-cased) flat volumes used to distribute ECR city carrier delivery costs. He implies that this causes

Saturation flats to be distributed too little city carrier delivery cost (page 19). But this implication is wrong.

(1) Background

The new USPS city carrier delivery study identifies volume-variable out-of-office (delivery) cost pools for letters, flats, "sequenced" or non-cased mail, small and large parcels, accountables and collectibles. By comparison to the old set of studies, the new study introduces three new cost pools: the "sequenced" pool, the small parcel pool, and the large parcel pool. The "sequenced" pool is relevant for this discussion. "Sequenced" mail is non-carrier-cased Saturation mail that is taken directly to the street by the city carrier as an extra bundle or tray.[8] The USPS City Carrier Cost System (CCS) collects the delivered rate category shape-related volumes used to distribute those cost pools. Unfortunately, the CCS does not yet separate out those volumes by "sequenced" and non-"sequenced." So, the CCS Saturation letter and flat volumes that are "sequenced" and "non-sequenced" must be estimated so that they can be used as *distribution keys relevant to the volume-variable delivery cost pools*.

USPS witness Kelley (USPS-T-16) does this in three steps:

- Saturation letter and flat city carrier in-office casing costs are individually identified from the IOCS data.

- Saturation letter and flat casing productivities from USPS witness Shipe (USPS-T-10) in R90-1, together with base-year direct city carrier workhour cost, are used to estimate unit base-year costs to case Saturation letters and, separately, Saturation flats.

- Total Saturation letter and flat in-office casing costs are each then divided by the respective estimates of unit casing cost to obtain separate estimates of the number of cased Saturation letters and flats.

[8] In Section IV below, sequenced mail is called extra-bundle or extra-tray mail. In these discussions, the term "sequenced" mail should not be confused with delivery-point-sequenced of walk-sequenced mail. The former is a subset of the latter but not all of the latter may be considered "sequenced," as the term is used here.

Then Mr. Kelley's estimates of sequenced CCS Saturation letters, flats, and parcels are used to distribute the sequenced mail volume-variable delivery cost pool to each shape.[9] And, the estimates of non-sequenced CCS Saturation letters and flats are used in the distribution keys for the letter and flat volume-variable delivery cost pools. The latter are simply the differences between (a) total CCS Saturation volumes by shape and (b) estimated CCS Saturation "sequenced" volumes by shape. In this discussion, it is important to note that CCS volumes are used as *both* the subclass and intra-subclass distribution keys for the various delivery cost pools.

(2) The "Problem"

Dr. Haldi points out that Mr. Kelley's estimate of "sequenced" Saturation flats is understated. This is because, when a DAL is being handled at the time an In Office Cost System (IOCS) tally is taken, the USPS attributes that tally to its host flat or parcel. Thus, the IOCS in-office casing cost for ECR Saturation flats (used in Mr. Kelley's Step 1) includes the costs for casing DALs as well as flats. As a result, his estimate of cased flats is overstated while his estimate of uncased or sequenced flats is understated.[10] And, understating the volume of sequenced Saturation flats understates the share of the sequenced delivery cost distributed to Saturation flats, thereby overstating the share of sequenced delivery cost distributed to Saturation letters.

[9] Small Saturation parcels are neither cased nor sequenced.

[10] If some of the IOCS flat casing cost used by Mr. Kelley to estimate is caused by DALs, then only a portion of that cost is caused by flats.

However, Dr. Haldi stops his explanation at that point, not taking the analysis to its ultimate conclusion. If the number of CCS "sequenced" flats is under-estimated (for purposes of distributing the sequenced or non-cased cost pool), then the number of CCS "non-sequenced" or cased flats is over-estimated (for purposes of distributing the cased flat cost pool). If the latter is the case, then Saturation flats are currently distributed too much of the cased flat delivery cost pool. And, because sequenced delivery unit cost is less than regular delivery unit cost, a correction of the total delivery costs for Saturation flats (and for ECR in total) would make it lower – reducing it even moreso than the reduction in delivery unit cost for Saturation letters noted by Dr. Haldi.[11]

B. DALs Do Not Impact Letter Mail Processing Costs

On pages 19 through 21 of his testimony, Dr. Haldi asserts that some unknown, possibly large, and growing volume of DALs is being sorted on automation equipment. He then implies that the costs incurred to process DALs on automation are being wrongly attributed by the IOCS to Saturation letters.[12] His concerns in this regard are extremely overblown.

Dr. Haldi bases his assertion on three points. First, he notes that USPS witness Lewis (USPS-T-30) stated that ". . . there is field interest in DPSing the letter-shaped component of a DAL mailing and . . . in some places delivery and

[11] A larger flat sequenced volume will shift some sequenced delivery cost from Saturation letters back to Saturation flats. For that reason alone, Saturation letter delivery cost will also decline but not to the extent of the decline in Saturation flat costs given that flats would experience a far greater cost reduction as compared to Saturation letters. Depending upon the extent of the correction, this could amount to a substantially lower flat cost and letter-flat cost differential.

[12] Dr. Haldi also implies that any transportation cost to take DALs from the DDU to the plant and back again is wrongly attributed to saturation letters. But, such transportation is through either the Vehicle Delivery Service or Purchased Transportation and neither cost segment uses a shape-related distribution key.

plant managers have implemented local procedures to do this" (response to VP/USPS-T30-14). Second, he points out that costs in the BCS and OCR MODS cost pool are being attributed to Saturation letters despite the fact that Saturation letters must be barcoded while DALs are exempt from the barcoding requirement. And, third, he implies that IOCS tally-takers are unable to identify DALs at the mail processing plant and would therefore call them Saturation letters.

With respect to USPS automation of DALs, Mr. Lewis simply expressed the USPS interest in DPSing DALs but he also explained that ". . . it's got to be a pretty small number at this point." (Tr. 6/2433) Further, in response to a Valpak question during cross, the USPS responded that a review of the FY04 IOCS data indicated that there were no Standard Mail DAL tallies in the MODS cost pool BCS/DBCS.[13] Finally, in response to Valpak interrogatories, ADVO data show that only 0.57% of all DALs it reports (for itself, MMSI, and ANNE) are barcoded and, despite the miniscule barcoding percentage, it is unlikely that those DALs were actually automated. The ADVO-provided data also show that there are no plans to barcode any DALs in the near future.

Thus, given the DALs' physical characteristics, it is highly unlikely that they could not only be processed on an OCR but also then processed on the two-pass DBCS/CSBCS (as speculated by Dr. Haldi on page 21). Further, virtually all Saturation flats with DALs are dropped at the DDU. The DALs' very

[13]USPS Response to Valpak request at Tr. 7/27179. Notably, in LR K-67 where unit delivery costs are estimated, Mr. Kelley assumes that no DALs are DPSed but are instead either cased or taken to the street as extra bundles.

purpose in accompanying their host flats means that the USPS would have to ensure unusual coordination between the plant and the DDU before they could be transported upstream, processed over night, and returned in a such a way as to ensure their delivery at the same time as their host flats.[14]

With respect to the alleged incorrect IOCS attribution of DAL costs to Saturation letters, Dr. Haldi notes that there are Saturation letter costs in the OCR/BCS MODS cost pool. Because Saturation letters are already barcoded, he jumps to the conclusion that they would have no OCR/BCS cost (and therefore that cost must instead be caused by DALs). However, the amount of Saturation letter OCR/BCS unit cost is less than a hundredth of a cent and could easily be caused by Saturation letters requiring OCR/BCS processing because of inaccurate or unreadable barcodes. Further, USPS Handbook F-45, pages 12-8 to 12-11 (USPS LR-I-14, "Question 22") explains that when a DAL is the subject of an IOCS tally, that tally is attributed to the host piece. In the event that a host piece cannot be identified, IOCS editing process attributes them to flats (LR K-9, Appendix B, page 137).[15]

It is clear that there must be extremely few if any DALs processed on automation equipment. Further, even if there were automated DALs, the vast

[14]When asked for support for his assertion regarding a large and growing number of DALs being automated, Dr. Haldi responds with cites from Docket R2001-1 where a USPS witness states (1) that running DALs on DPS equipment is inconsistent with keeping DALs matched up with the matching host pieces and (2) it is highly unlikely, if ever, that DALs are run on DPS automation. (Response to ADVO/VP-T2-6.) These simply describe the reality that DALs are very rarely, if ever, run on automation equipment.

[15] USPS Response to Valpak request at Tr. 7/27179.

majority of the time, the IOCS would correctly identify them as DALs and attribute their costs to their host flats or parcels.[16],[17]

C. The Postal Data Systems Are Not Biased Against Letters

Dr. Haldi notes what he considers to be mismatches between revenues and volumes on one hand and costs on the other (pages 22-24). He notes that letter-shapes occur in all weight ranges while letter rates apply only to letter-shapes weighing 3.5 ounces or less. And, he believes that it is more likely that the postal cost systems will record a letter-shaped piece over 3.5 ounces as a "letter" than record letter-shaped piece under 3.5 ounces as a "flat." As a result, he leads the Commission to believe that there may be a serious bias against ECR letters, attributing non-letter costs to letters.

However, though the postal cost and volume data used to develop unit cost by shape are not as precise as Dr. Haldi would like them, they do not appear to be biased or seriously mismatched. The postal cost data are collected on the

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[16]In response to ADVO/VP-T2-7 concerning his hypothesized DAL automation costs, Dr. Haldi claims that the Question 22 DAL instructions cover only single piece tallies. He also speculates that DALs may be handled in non-single-piece mail handling tallies along with other letter-shaped pieces and the tester would consider them Saturation letters and would not have the appropriate instruction on how to identify them as DALs. (Response to ADVO/VP-T2-7) His characterization of the IOCS instructions is a bit misleading. According to USPS Handbook F-45 (pages 12-4 to 12-5, 12-8 to 12-11, 17-2), Question 22 applies to mail that is either a single piece, an identical mailing, or a non-identical mailing (in items or containers) subject to the top piece rule. Question 22 does not apply when the tester finds non-identical or mixed mail (page 17-2 of Handbook F-45). If the mixed mail container can be counted, then, per Question 24 applies and DALs may be counted as "cards." If the mixed mail container cannot be counted, then either Question 25 (regarding Special Services) or Question 26 (attributing the container by Basic Function) apply. Thus, even if there were some DALs in the automation mailstream, their possible mixed mail tally costs, if any, would be miniscule.

not subject to the top-piece rule

[17] The mixed-mail issue also applies for city carrier in-office costs. But, if any DAL mixed mail cost is attributed to Saturation letters, it should be an extremely minor amount. DALs are not handled as mixed mail in containers except when the carrier is moving, in some sort of rolling container, all his cased and strapped mail to either his truck or relay arrangements. As Dr. Haldi notes, tallies associated with this operation are "minimal" (page 38) and tally costs for each individual mail type counted in that single tally are likely to be miniscule.

basis of shape or operation related to shape.[18] So, costs for letter-shape pieces weighing more than 3.5 ounces are likely included in letter cost. But, the postal RPW volumes by shape are used with those shape costs to determine unit cost by shape. Like costs by shape, RPW volumes are also identified on the basis of shape or operational category and have letter-shape pieces weighing more than 3.5 ounces. The result is that letter-shape costs are divided by RPW letter-shape volumes to determine unit letter cost, with the letter-shape definition being roughly the same for both costs and volumes. Thus, the USPS approach matches up shape-related costs with shape-related volumes and permits rational data collection procedures.

Apparently, to determine the extent of the bias against letters in the In-Office Cost System (IOCS), Valpak submitted a series of questions to the USPS on this issue. The USPS responses provide ECR volumes and IOCS costs by shape and weight increment. For Saturation, those data show the following:

- Saturation Letter RPW volumes (including those over 3.5 ounces) exceed Billing Determinant Letter volumes by 7.7 percent. (VP/USPS-T16-2 and LR K-115)

- Saturation Letter IOCS costs for letter-shapes at all piece weights exceed IOCS costs for letter-shapes at or below 3.5 ounces by 6.9 percent. (USPS LR K-146, provided in response to VP/USPS-13)

- RPW letter-shape volume at or below 3.5 ounces is 5.5 percent greater than total Billing Determinant volume (letters up to 3.5 ounces). (USPS LR K-146, provided in response to VP/USPS-13)

[18] See, e.g., Handbook F-45, p. 111ff, and Handbook F-65, pages 110ff, 113ff, and 213ff. Dr. Haldi's concern that a heavy letter may be categorized as a flat because of its piece weight is unfounded. In the USPS costing systems, shape data are based on piece dimensions or operational category, not on piece weight. The IOCS, CCS, and RCS data systems use piece weight principally to identify various subclasses (e.g., First Class vs. Priority) and not to identify shape.

- Saturation non-letter RPW volume is only 97.3 percent of total Billing Determinant non-letter volume. (VP/USPS-T16-2 and LR K-115)

Thus, contrary to Dr. Haldi's contention of bias against letters, it appears that many more Billing Determinant flats are recorded as RPW letter volume than the reverse. Based on that information for IOCS costs, one might say that the Saturation letter volumes in the denominator of the unit cost calculation appear overstated and therefore Saturation letter unit cost appears understated. Depending on one's bias and choice of data source, it would be easy to argue either of the following: that unit Saturation letter IOCS cost is too low relative to Saturation flats or the opposite.

Actually, the truth is that, either way, the per-piece IOCS cost variances appear to be very small – less than one-tenth of a cent. And, although there is some small imprecision in the estimate of IOCS letter and flat costs and RPW volumes, it really is not possible to tell whether that imprecision is biased one way or the other.

Moreover, with respect to the city and rural carrier cost systems that are far more important to Saturation mail costing, their volumes and attributable cost pools by shape are specifically designed to match precisely. There should be no "mismatch" problems at all for these systems. In this particular case, however, there is an exception – the matching of the new city carrier sequenced cost pool with its estimated CCS volumes. As discussed in Section III.A, there appears to be a clear bias that lowers Saturation letter cost relative to Saturation flat cost.

Hence, the USPS data system results should be considered reasonable and, if anything, favoring Saturation letters over flats.

D. Summary: Saturation Letter Costs Are Not Excessive Compared to Saturation Flat Costs

Dr. Haldi, apparently to support Mr. Mitchell's letter-flat rate passthrough proposal, attempts to provide reasons to believe that the unit cost difference between Saturation letters and Saturation flats is much greater than the USPS has estimated. With respect to his revised DAL volume estimate, I have demonstrated in Section II that the resulting costs from that revision provide no reason to reject the proposed USPS rates.

With respect to his concerns about hypothetical DAL mail processing costs being attributed to Saturation letters and a potential postal cost systems bias in favor of non-letters are also unsupported and would likely amount to very little cost difference in any case. However, his identification of the potential impact of DALs on city carrier casing and out-of-office delivery costs does indicate that both Saturation letters and flats may be attributed too much delivery cost, with Saturation flats being attributed far more than Saturation letters. Of his expressed data quality and "mismatch" concerns, this latter has the potential for substantially reducing the disparity between Saturation letter and flat unit costs.

IV. VP WITNESS HALDI'S CAPACITY CONSTRAINT THEORY DOES NOT DESCRIBE THE REAL WORLD

In another effort to expand the cost differential between Saturation letters and flats, Dr. Haldi has introduced a dramatically new theory regarding city carrier delivery costs. Briefly, he implies that city carrier capacity to handle Saturation mail in the lowest-cost manner (as a third bundle) is filled and, as a result, most Saturation letters and some Saturation flats must be handled in a higher-cost manner. Thus, according to Dr. Haldi, the marginal cost of city delivery for this mail is much greater than estimated through the USPS cost systems. To correct for this, he proposes that city delivery costs for Saturation letters and flats be modeled as if they *all* were handled in the higher-cost way.

As discussed below, Dr. Haldi's theory ignores operational realities. City carriers have considerable capacity to carry out Saturation mail as extra bundles. However, there are non-capacity-, non-flat-related reasons why more Saturation letters are not. His proposal to use modeled delivery cost at the Saturation level is completely unsupported by any facts and should be rejected.

A. The Third Bundle Rule

City carriers usually have only two categories of mail to deliver: (1) letters that have been DPSed by the postal plant and provided to the carriers as they leave for their route and (2) non-DPSed letters and flats that have been cased together in a vertical flat case. However, the mechanism for delivering this mail differs according to the type of delivery sections the carriers serve. When delivering to foot and park-and-loop delivery sections where the carriers walk to multiple delivery points, they carry each category of mail as a bundle while they walk, pulling mail for each delivery point from the bundles as needed. However, when delivering to other delivery sections (curbline, dismount, centralized, NDCBU), the carriers simply pull the mail from trays in their vehicle when they

arrive at a delivery point (or set of delivery points). In some cases, they may take trays into a set of delivery points (e.g., indoor centralized or NDCBU deliveries). Most carriers have more than one type of delivery point and more than one type of delivery section on their routes.

For foot and park-and-loop delivery sections, carriers may add a third bundle of "sequenced" or extra-bundle Saturation mail. Due to labor agreement rules, though, they may not be required to carry more than three bundles of mail while walking. For other delivery sections, the labor agreement specifies no constraint on the number of extra trays the carriers may use.

B. Dr. Haldi's Theory

When city carriers are able to avoid casing Saturation (walk-sequenced) mail and instead carry it out to the route as separate or extra bundles and trays, they avoid costs. So, "sequenced" or extra-bundle/tray mail taken out by carriers as extra bundles or extra trays has the lowest delivery cost. [19] Because of the third-bundle rule for foot and park-and-loop delivery sections and because there may be an unknown upper limit to the number of "extra trays" a motorized carrier can access at one time, Dr. Haldi implies that the USPS has reached or is on the brink of reaching its capacity to handle Saturation mail as non-cased extra bundles on city carrier routes (pages 28-31).

As a consequence of this hypothetical constraint, Dr. Haldi implies that any marginal (new) Saturation mailing must be cased and thus the marginal cost of all Saturation must be the unit cased cost. Apparently, the fact that there are cased Saturation letters and flats leads him to this conclusion (page 33). Further,

[19]For purposes of the discussion, this uncased, sequenced mail will be called "extra bundle" mail although it may also be "extra tray" mail, depending upon how the city carriers handle it. The modeled city carrier delivery time for cased and DPS volume is higher than for extra-bundle/extra-tray volume. Extra-bundle volume avoids in-office carrier casing and the out-of-office delivery cost for such mail is also lower than for delivery of cased/DPS mail. Of course, DPSed letters also avoid in-office casing costs.

he theorizes that Saturation letters are generally not taken out as extra-bundle mail because the USPS reserves that capacity for Saturation flats.

According to Dr. Haldi, because of the extra-bundle capacity constraint and the USPS reservation of that capacity for Saturation flats, Saturation letters must undergo more costly carrier casing and delivery than do Saturation flats (pages 32-33). He also implies that some Saturation flats are also not accorded the low-cost extra-bundle treatment because of the capacity constraint (pages 32-33). Because of this capacity constraint, he believes the postal delivery cost system does not correctly estimate Saturation letter and flat marginal costs. So, he proposes that the Commission use much-higher, modeled city carrier cased delivery costs to estimate Saturation letter and flat costs, but *only* for purposes of developing the Saturation letter-flat cost differential (pages 55-56).

C. There is Real World Carrier Extra-Bundle Capacity

Dr. Haldi's implications are exaggerated and unrealistic. In order for his analysis and proposed solution to be correct, there would have to be zero extra-bundle or extra-tray capacity anywhere in the system of city carrier routes and on all delivery days of the year. But that is clearly ridiculous. He does not consider how differences in delivery types affect capacity, different ways in which the USPS can expand its capacity, real evidence of capacity fill, or reasons why some Saturation mail may not be carried out as an extra bundle.

(1) USPS Techniques to Expand Extra-Bundle Capacity

The USPS appears to have considerable capacity to handle all mail that, in its opinion, can be most efficiently handled as extra-bundle mail:

- For the curbline, centralized/cluster box, and dismount deliveries that account for over 60 percent of all city delivery points,[20] city

[20]The further response of USPS witness Lewis to oral request from Valpak (Tr._____) identified 55.7percent from curbline and centralized/cluster box deliveries. The percentage of dismount deliveries was not separately provided in that response. However, if 30 percent of deliveries on

carriers can take out multiple extra bundles/trays. This applies to both Saturation letters and Saturation flats.

- For all deliveries, city carriers, if they have too many Saturation mailings to handle as an extra bundle on one day, may defer some of those mailings to the next day or two.[21]

- For park-and-loop and foot deliveries, city carriers can take out multiple Saturation flat mailings when they collate them into a single extra bundle. However, they may not carry many Saturation letter mailings out as extra bundles because, physically, some of them (depending upon their dimensions and weight) may be difficult to handle as extra bundles.[22]

Thus, city carriers have substantially more capacity to handle extra bundles than recognized by Dr. Haldi.

(2) Evidence of Capacity to Handle Extra Bundles

The capacity-expanding techniques listed in the previous subsection are supported by actual data. In this case, witnesses Stevens (USPS-T-15) and Bradley (USPS-T-14) sponsor the extensive results of a survey of city carrier out-of-office time carried out in FY02 – the City Carrier Street Time Survey (CCSTS) data for use in developing Dr. Bradley's new econometric models of city carrier delivery time. Volumes in that data include the number of extra-bundle or "sequenced" pieces delivered to each sampled route on each sampled day.

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dismount routes were considered dismount, then another 5 percent of delivery points would be included in the above, making the figure over 60 percent. (See also USPS response to VP/USPS-T30-21.)

[21] See USPS response to ADVO/USPS-8. There is also considerable coordination between the USPS and Saturation mailers, particularly those that mail on a regular, high frequency basis. And, some Saturation mailers accept and account for the fact that there may be not just a two-day delivery window but a three-day window for their mail, depending upon drop time and coordination arrangements.

[22] See, e.g., USPS response to ADVO/USPS-9.

With the exception of Saturation DPS letters, the USPS has consistently stated that city carriers attempt to take out all eligible Saturation mail as extra bundles or trays.[23] Thus, one would expect that actual data on the number of extra-bundle mailings handled by city carriers on their routes each day would provide an accurate measure of the amount of extra-bundle mailings they now carry out and their capacity to handle more.

Of the 32,064 route-days from 3,396 sampled routes surveyed in the CCSTS, 65.8 percent of route-days had no extra-bundle mail, suggesting that there are many days where there is no extra-bundle mail but which could be used either for a new or deferred Saturation mailing, if the latter were necessary.[24] Of the 34.2 percent of route-days that had extra-bundle mail, 26.1 percent had only one full or a partial extra-bundle mailing while 6.3 percent had one to two such mailings. (A partial mailing means not all deliveries on the route received an extra-bundle piece.) Less than 1% of route days had three or more extra-bundle mailings.

Of the 3,396 CCSTS sampled routes, 87.4 percent had some extra-bundle/tray mail during the sample period.[25] For those routes that had some

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[23] See, e.g., USPS responses to ADVO/USPS-6, 7, 8, 9 and 10. By "eligible," I mean that it would be more efficient to take that mail out as an extra bundle rather than casing it.

[24] The route and route-day information is based on the sample-weighted data used by Dr. Bradley, adjusted to remove the problem zip-codes that he also deleted in his analysis. An extra-bundle mailing in this data is defined as one "sequenced" piece per possible delivery on the route on a specific day. Thus one mailing means a "sequenced" piece is delivered to every delivery on the route on that day. And, if only a portion of a Saturation mailing is carried out as extra bundles or trays on a particular day, then the there is something less than one extra-bundle mailing for that route-day (but not zero). See ADVO LR-2.

[25] Of interest, the percentage of routes with extra-bundle mail during the sample period was also calculated. The percentages show that more dismount and curbline routes (39.0 percent of all city routes) have extra-bundle mail than do the other route types while foot and other routes (7.6

extra-bundle mail during the period, on average, almost 61 percent of their delivery days had no extra-bundle mail. And, for those same routes, 74.3 percent averaged 0.5 or less extra-bundle pieces per delivery per day during the survey period and 95.1 percent averaged 1 or fewer extra-bundle pieces per delivery per day during the survey period.[26]

All this together means that, on average, there are many route-days when there is no extra-bundle mail and therefore a new or deferred "eligible" mailing can be accommodated very easily as an extra-bundle/tray. And, further, there are many route-days where there is only one (or a portion of one) extra-bundle/tray mailing and an additional "eligible" mailing may be either collated into the extra bundle or carried out as extra trays.

Thus, in the vast majority of cases, the USPS has sufficient capacity to handle additional Saturation mailings as extra bundles either through deferral, collation, or by carrying them as extra trays (rather than bundles), as long as those additional mailings have the appropriate physical characteristics. And, most importantly, in those instances where carriers case or collate Saturation mail, the postal data systems recognize that situation and record it appropriately.

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percent of all city routes) have the least amount. This is useful to know since the two former route types have more of curbline and dismount type deliveries where extra trays, not subject to the constraint, are used. In other words, it appears that Saturation mail that can be handled as an extra bundle/tray is destined more often for curbline and dismount route types than to any other route type.

[26] For park-and-loop routes alone, which account for 53.4 percent of all city routes, 87.3 percent had extra-bundle mail during the sample period. And, for those routes that had such mail, 63.3 percent of the delivery days had no extra-bundle mail. And, finally, 81.6 percent of those routes averaged 0.5 or less extra-bundle pieces per day during the survey period and 97.7 percent of them averaged one or less.

(3) Actual Levels of DPSed, Cased and Sequenced Saturation Mail

Dr. Haldi relies on the USPS estimated proportions of Saturation letters and flats that are cased or DPSed to argue that city carriers do not have sufficient extra-bundle capacity to take them out as extra bundles. For Saturation letters, he also asserts that they have been deliberately excluded from extra-bundle treatment because of the more-pressing need to take out Saturation flats as extra bundles. As noted above, he does not consider any other reasons why some Saturation letters are not handled as extra bundles or trays.

Saturation Flats

As Dr. Haldi has stated,[27] it is likely that the USPS estimate of the percentage Saturation flats on city routes that are handled as extra bundles (74.4 percent) is understated. In fact, it is quite likely that virtually all Saturation flat mail is extra-bundle/tray mail.[28] So, it appears that Saturation flats are unaffected by the extra bundle constraint.

Saturation Letters

Saturation letters, however, have a different story. One major reason why fewer Saturation letters are carried out as extra bundles (compared to flats) is that the USPS tries to DPS all Saturation letters delivered to DPS zones. Even when the mailer drops the mail at the DDU, the USPS carries those DDU letters back to the plant to be DPSed.[29] The USPS estimated that 47.5

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[27] See page 19 of VP-T-2 and response to ADVO/VP-T2-4

[28] Based on the information from USPS LR K-67 (Casing04_Revised.xls), it appears that all of the Saturation flat casing cost could be caused by casing just a portion of the CCS number of DALs alone.

[29] See USPS responses to ADVO/USPS-1-6.

percent of CCS Saturation (non-DAL) letters are DPSed.[30] However, given the revision in the number of actual Saturation non-DAL letters plus the known amount of CCS DPS (non-DAL) letters, it appears that the proportion of CCS Saturation (non-DAL) letters that are DPSed is greater – estimated at 56.5 percent. This appears more consistent with postal DPS policy.

And, what about the remaining 43.5 percent of Saturation non-DAL letters delivered by city carriers? They are either delivered in non-DPS zones, or are not DPSed because of service requirements, or are DPS rejects that the processing facility sends down to the DDU for carriers to case. Based on the USPS original proportions, roughly half are cased and the other half are sequenced – an even lower proportion than that cited by Dr. Haldi.[31]

With respect to those that are cased, it is likely that some Saturation letters do not have the appropriate physical characteristics to make extra-bundle treatment efficient. Their relatively small dimensions and lightweight make them difficult for carriers to hold firmly in the crook of their arm, as they do with the physically larger and heavier Saturation flats. And, holding the extra letter bundle between the fingers of their hand, along with the DPS bundle, is a much more

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[30] The USPS estimated that the remaining Saturation non-DPS, non-DAL letters on city routes were evenly divided between cased and extra-bundle/tray mail. (FY04.ECRSat.Vols_Revised.xls in LR K-67)

[31] The USPS estimate of cased letters in LR K-67 was based on the R90-1 witness Shipe walk-sequenced letter productivity. The Shipe productivity, however, has undoubtedly declined over time with the shift from using letter cases to vertical flat cases. So, while there is a lesser number of cased Saturation letters, the total casing cost is the same because the unit casing cost is much higher than the R90 productivity. See USPS-RT-__ (Jeffrey Lewis) in MC95-1.

difficult technique.[32] However, the physical characteristics of letters clearly do not prevent them from being carried as extra trays in the case of curbline, dismount, and centralized delivery sections. Thus, Saturation letters, when appropriate, also benefit from the "extra-bundle/tray" cost avoidances, consistent with USPS statements on this matter.[33]

In any case, the fact that Saturation letters are not handled as extra bundles/trays as often as Dr. Haldi would like has nothing to do with the city carriers' capacity to take out extra bundles or the presence of Saturation flat mailings, but has everything to do with the physical characteristics of Saturation letters and the USPS DPS policy.

D. Dr. Haldi's Proposed Modeled Costs Should Be Rejected

Dr. Haldi's proposed solution to his perceived capacity constraint and marginal cost estimate problem is to model Saturation letter and flat delivery costs as though city carriers cased them 100 percent of the time (pages 55-57). But, under Dr. Haldi's capacity constraint theory, this solution assumes that, for *all* carriers on *all* routes on *all* delivery days, there is no further capacity to carry out an additional extra bundle or tray mailing – in other words, any marginal (but eligible) Saturation mailing arriving at *any* time for *any* route would have to be cased rather than carried out as an extra bundle. It assumes that, on all routes and on all days, the marginal (additional) mailing could not be collated with another, could not be deferred, and could not be carried out as an extra tray.

[32] See USPS response to ADVO/USPS-9.

[33] See USPS response to ADVO/USPS-9.

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This is such an extreme and radical assumption that even Dr. Haldi shies away from claiming that he believes it.[34]

Moreover, contrary to Dr. Haldi's implication, the only instances where the USPS data systems may incorrectly record the marginal cost of Saturation mail as being extra-bundle rather than cased is when the carrier is actually handling the mail as an extra-bundle/tray but has no further capacity to handle another mailing in the same manner. Given the capacity-expanding technology and the CCSTS survey data results, such an event would have to be rare.

Separately, Dr. Haldi has not quantified the total unit delivery costs his marginal cost proposal would produce. But, it is clear that the estimates would be very large relative to those produced by either the USPS or PRC cost methods. Interestingly, he proposes to use them only for purposes of establishing the Saturation letter-flat cost differential, which would result in a lower Saturation letter rate, but not for the density-related cost differentials that, when included in the rate structure algorithm, would increase the Saturation letter rate.

E. Summary: There is No Need for Modeled Delivery Costs

There is no evidence that the city carriers have come anywhere close to reaching their capacity to handle appropriate types of Saturation mail as extra bundles or extra trays. But, there is evidence that city carriers still have considerable capacity remaining to handle marginal increases in Saturation mailings.

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[34] See Dr. Haldi's response to ADVO/VP-T2-24.

Moreover, there is also evidence that even more Saturation flats are treated as extra bundles and more Saturation non-DAL letters are DPSed than the USPS estimated. And, the reason most Saturation letters are not treated as extra bundles/trays is due to the USPS DPS policy and the physical characteristics of the letters that are not DPSed. Finally, the reasons why Saturation letters are not treated as extra bundles as often as Saturation flats have nothing to do with either capacity constraints or capacity reserved only for flats.

Finally, Dr. Haldi's proposed solution to his capacity constraint problem is to model as cased delivery both Saturation letter and flat unit city delivery costs. This treatment assumes that there is no spare capacity anywhere in the system at any time in the system – an extreme and completely unrealistic assumption that even he cannot claim to believe. Moreover, his proposal would have the effect of radically increasing the unit delivery costs of both Saturation letters and flats, thus exaggerating the cost differential between them. And, he proposes only using the modeled costs to develop the letter-flat cost differential (and not the density-related cost differentials) – a seemingly results-oriented proposal.

Both Dr. Haldi's contention that city carriers are at or near their capacity to take out extra bundles and trays as well as his modeled delivery cost proposal should be rejected.

AUTOBIOGRAPHICAL SKETCH

My name is Antoinette Crowder and I am a principal with Eagle Analytics LLC, an economic and financial consulting firm located in Alexandria, Virginia. I specialize in regulatory policy, economics, and finance, particular with respect to Postal Services. I have been involved in this type of consulting for over thirty-two years, twenty-seven of them with Transcomm, Inc., an economic and engineering firm. Over all that time, I have been involved in a variety of projects dealing with costing, pricing, market and demand studies, economic and financial analyses, survey design, and research on numerous regulatory and policy issues. These activities have concerned the electric power, gas, communications, and postal/publishing industries. I have prepared or assisted in preparing numerous filings at various federal and state regulatory agencies on behalf of numerous clients. In addition, I have provided overseas consulting activities, providing financial, economic and regulatory assistance to multi-national organizations, international firms, and national governments.

I have been involved in postal ratemaking and policy issues since the beginning of the R77-1 rate case. My work has included analysis of revenue requirement, cost attribution and distribution, subclass rate structure and discounts, institutional cost allocations, service-quality measurement, demand and market assessment, and mail classification issues.

I have testified before the Postal Rate Commission in eight proceedings and have contributed to development of other testimony presented to the Commission. In Docket R84-1, I contributed to the mail processing peak-load and second-class intra-SCF discount testimony. In Docket R87-1, I contributed to testimony on city carrier-out-of-office costs and third-class/fourth-class Bound Printed Matter drop-ship discounts, and I also prepared and presented rebuttal testimony on third-class presort discounts. In Dockets C89-3/MC89-1, I helped prepare and presented direct testimony on the proposed local saturation subclass. In Docket R90-1, I assisted in preparation of city carrier out-of-office cost and institutional cost coverage testimony and prepared and presented rebuttal testimony on third-class rates. In the R90-1 Remand, on behalf of a third-class mailer's group, I presented two pieces of rebuttal testimony in Docket R94-1 and rebuttal testimony in MC95-1. In Docket R97-1, I presented testimony in response to Presiding Officer's Notice of Inquiry No. 3 on city delivery carrier load time costs and rebuttal testimony on carrier costs and rate design issues. In Docket R2000-1, on behalf of several mailers and mailing groups, I presented testimony on city delivery carrier costs. I also presented rebuttal in that docket concerning ECR rates.

Over the course of my 28-year involvement in postal ratemaking matters, I have had numerous opportunities to observe postal operations and have analyzed the cost aspects of those operations. I have also become familiar with economic costing and pricing concepts, both generally and as applied to postal ratemaking.

My education includes a B.S. in Biology from the University of Virginia, an M.S. in Biology from George Mason University, and additional course work in economics, mathematics, and statistics.

MR. McLAUGHLIN: Your Honor, Witness Crowder also sponsors two library references that are Category 2 library references underlying her testimony. Those are ADVO-LR-1 and ADVO-LR-2. Would you prefer that those be moved into evidence as well, although they will not be transcribed?

(The documents referred to were marked for identification as ADVO-LR-1 and ADVO-LR-2.)

CHAIRMAN OMAS: Without objection.

(The documents referred to, previously identified as ADVO-LR-1 and ADVO-LR-2 were received in evidence.)

CHAIRMAN OMAS: This brings us to oral cross-examination. One party has requested oral cross-examination, Val-Pak Directing Marketing Systems, Inc., and Val-Pak Dealers Association, Inc.

Is there any other -- who wishes to cross-examine this witness? Mr. Olson, you may begin.

CROSS-EXAMINATION

BY MR. OLSON:

Q Thank you. Ms. Crowder, William Olson representing Val-Pak Directing Marketing Systems,

Inc., and Val-Pak Dealers Association, Inc.

A Good morning.

Q Good morning. I want to begin with some questions about city carriers' street time and rural carrier costs and the estimates that were made of those costs by Witness Kelley and how you modified those estimates in your testimony and your library reference. I don't recall if that was Library Reference 1 or 2.

A It was one.

Q Number one. Thank you. I actually have a sheet which has some of this information on it. I know you haven't had a chance to look at it.

A I haven't looked at it.

MR. OLSON: Yes, I'm sure. I only gave it to your counsel this morning, but if I can just hand this out, and I'm not sure how much we'll use it, but it might be helpful in clarifying some discussion.

(Pause.)

MR. OLSON: Mr. Chairman, I've already distributed copies among the table up here and have some extra if others would like some.

BY MR. OLSON:

Q Ms. Crowder, since you do modify what Witness Kelley did, I want to go back and just make

sure we have a clear understanding of what he did before you modified it.

A Okay.

Q And his testimony, USPS-T-16, had a chart in it which, as you probably will recall, showed two different ways to calculate letter and flat unit carrier costs. Do you recall that chart?

A Yes, sir, I do.

Q Okay. And Witness Kelley's testimony didn't actually say which was the R-2001 methodology and which was the corrected methodology, but I think the top one was the R-2001, and the bottom one was the corrected methodology. Is that your recollection? I have them here, but --

A I might need them because I did not bring Kelley's material with me. That's not entirely correct because what Kelley did was use the Postal Service's new city carrier delivery cost analysis, and also he did something different with the rural carrier cost analysis than had been done in 2001. So really, the first set of costs really don't mean much of anything, as far as I'm concerned. They are not really the old method, and they are not really the new method. I don't know quite how to categorize them.

Q But in any event, the two approaches that he

set out in that chart, one approach was putting DALs in the numerator of letters where they do not belong, -- correct? -- which is the R-2001 approach.

A He put the cost of DALs -- actually I didn't really look at that particular analysis as closely as I looked at the one that really is relevant, which is the second set of numbers, but my understanding is that, yes, that's exactly what he did. He put the DAL costs in with the letter costs.

Q And really --

A Hold on just a minute.

Q I'm sorry.

A I want to make sure that I have the point clear. The DAL costs that he put in there were the QRC out-of-office DAL costs and some of the rural DAL costs.

Q Right. It wasn't all costs. It was city carrier street time and rural carrier costs. Correct?

A Right, right.

Q Okay. And what he did was, when he properly charged the DALs to flats in his revision, he used an assumption as to how many DALs there were in the system. Correct?

A Yes, sir.

Q And he did that based on the household diary

survey, and he calculated 3.375 billion DALs. Correct?

A In total on the system, as I recall, yes.

Q I think that was for test year '06, but I can't swear to that either. Do you recall?

A Yes. No. The 3.375 was a base year number. It was used to develop in final test year unit costs that Kelley presents in that table.

Q I'm sorry. Go ahead.

A What Kelley does, to begin with, is looks at the base year costs, so it's appropriate to look at base year volumes to go with base year costs, and after he has done all of that, then he pushes it up, inflates it, to the test year.

Q And when you say there were certain other changes that he used in using the new delivery cost methodology, that's for the 2001-1 methodology or for the corrected methodology?

A Repeat that. I'm not quite sure I understand it.

Q Yes. Well, a minute ago, I'm not sure I clearly understood what you said, but you said that one of the tables was a bit of a mishmash, --

A Yes.

Q -- that it was not a pure calculation

because it made certain changes, and I was trying to clarify which --

A Okay. Let me just repeat what I said.

Q Thank you.

A That first table, and I'm not entirely sure why Mr. Kelley did it, but that first table was using the Postal Service's proposed costs and all of the appropriate other assumptions with the single exception that he included certain detached label costs in with non-DAL letters, and that's really all that I think he did, but to be quite truthful, I didn't really bother with that one.

Q Okay. That's fine. Let's focus on the one you did work on.

A Okay.

Q I just want to note this one number, that when he came up with this table that you consider a bit of a mishmash of data, he had a letter cost in there of 6.665 cents.

A Am I supposed to look at this sheet now?

Q You could. I tried to extract the relevant numbers. There are no calculations in here except for the subtraction.

A Okay. All right. Like I said, I do not have Kelley's sheet, --

Q Right.

A -- but if you say that's what it was in that first set of numbers, then I'll accept that.

Q Okay. Well, the reason I'm focusing on that number is that when I went to your Library Reference 1 to see how you calculate these, when you change the estimate of the number of DALs, you change that number as an input, and I'm not sure why. It's a very small thing and perhaps not worth bothering, but Witness Kelley had a number in his table, 6.665, and in your, if you can look on my cross-examination exhibit, I just set out the number, and I say where exactly it comes from in your Library Reference 1, 6.651. I just wondered if that was intentional.

A No. I didn't do anything other than change the number of detached labels in the estimate that went through Mr. Kelley's spreadsheet. Now, I cannot explain why there is a slight difference, but I can guess that in those spreadsheets, which are rather complicated, there are times when ratios have to be used, and since that spreadsheet generates both sets of tables, if a ratio was slightly changed, particularly because the number of letters was changed, it could very easily -- I'm not surprised -- I didn't really look at it, but I'm not surprised that

it changed slightly.

Q There is also a tiny, corresponding change that is set out below in the flats cost. You see the first third of the page is letters, the second third is flats, and the bottom third is letter flat, and if you take a look right under where it says "flat unit cost," the Postal Service number was 3.191, and your number was 3.197, and the same thing, the same explanation, basically, tiny.

A Yeah. I think it has to do with the way the ratios were done, and I suspect it's probably on the rural side, knowing how that's done, but I really couldn't pinpoint it for you.

Q Okay. Let me suggest this one thing we noticed and see if this helps you explain what you think might have happened.

A Okay.

Q We saw a small shift in the rural carrier costs from ECR saturation letters to ECR saturation flats, and it's in the print version of K-67, and it's called "Revised Tab 2 Summary, Test Year Cells K-80 and 86," and I think it was about a 500-million shift of letters to flats, I believe, but I can't even recall that. It looked like it had been made intentionally. Is that something you can help us

with?

A That tab was, like, two or three or four, the tab number, and it was the test year summary costs. Can you tell me which tab that was that you're talking about?

Q Tab 2.

A Tab 2, and that's test year summary costs. I did not physically go into that particular sheet and make a change. Now, I suspect what might have happened, and tell me which way it went because I have a general understanding of how the rural --

Q Does this have to do with the rural cross-walk and some of the questions it raised?

A No. It's not really the rural cross-walk. There is a tab that estimates the cost for -- there's two pieces to the rural cross-walk, and one piece is not relevant any longer. It was back in the other case.

The other piece is we need to decide what proportion of box holders go to letters and what proportion go to flats, and there is a tab in there that does that, and when the estimate of labels is changed.

I did not touch that sheet, but the change in the number of labels flows through into that sheet,

and you can see it. So whatever happened in that sheet is what you see -- that's what you get, first, to Tab 11, which is base year, and then to Tab 2, which is test year.

The only physical change that I made was in the estimate of detached labels, which was in that other spreadsheet called the "DAL estimate" or whatever it was.

Q Exactly.

A That was the only change that I made.

Q Okay. Let's just talk about that one. I'm sorry to have to go through this, but, as you know, in rebuttal testimony, you don't have written, so --

A I understand. That's fine, and it's very complicated.

Q And I admire your ability to be able to put these numbers together. It exceeded our capability. It's very helpful. And that change of DAL estimate, you refer to in your testimony, I think, three times, and you call it a "corrected estimate." You don't actually deal with the numbers there, but I want to suggest three numbers and ask you if you can confirm these.

First of all, Witness Kelley, his original estimate, based on the household diary survey, was

3.375 billion DALs, and that's on this chart also.

A That's the total national number.

Q Yes.

A Okay.

Q As you said, for the base year.

A Uh-huh.

Q And that then after Mr. Kelley had his estimate, Dr. Haldi filed his initial testimony, and that estimate was 5.4 billion DALs. Correct?

A Yes, sir.

Q Okay. And then Dr. Haldi testified here or there on a Wednesday, and on Monday we got in the Advo responses, which gave clarity to what we thought we understood about the numbers from the SEC filings, and so Dr. Haldi revised his testimony on Tuesday, the day before he appeared, down to 4.5 billion. Is that correct, as you recall?

A (Laughter.) I'm not real good at remembering numbers.

Q Okay.

A If you say so, that's what it was. I know that we adjusted it slightly below that.

Q And that's really my question.

A That's about it. That's about it.

Q My understanding is that the number you use

in your Library Reference 1 on the DAL sheet there, that you use 4.315 billion DALs. Is that correct?

A Hold on just a minute. Let me just make sure.

Q Take your time.

A Yes. The estimate is really not my estimate. I wouldn't call it my estimate. It's what we've got. We just simply took Dr. Haldi's numbers, and then they were adjusted to reflect that there were some -- I believe it was in the other category -- that really were not saturation, detached-label mailings, and so those were pulled out. The remainder that he had proposed was left in there, and so the result is 4.315 billion total national.

Q Okay. So in terms of the validity of that as being an accurate number, you said it wasn't your estimate. Are you saying that's the number the Commission should use as it goes forward?

A That's the only number I have, sir. It's the only number I have.

Q Would it be fair to say that that number includes the Advo family of companies and Hart Hanks and another -- I believe it's 160 million that were on Mr. McLaughlin's cross-examination exhibit for Dr. Haldi as DALs?

A Yeah. That sounds about right, uh-huh.

Q Okay. In other words, it's the ones that you counted. There is no estimate in there for the unknown, for smaller DAL mailers around the country that were not on those lists that Dr. Haldi provided. Correct? It's only the ones you could count; you're not estimating --

A I took Dr. Haldi's numbers and just made that one adjustment, and that's what I've gotten. That's the best estimate I have, so that's what I used.

Q Do you have an opinion as to whether that's the estimate the Commission should use?

A If the choice is between the 4.3 and the 3.4, then 4.3 looks like it's more accurate, and I think that's what they should use.

Q And did you notice -- by the way, I know you endorsed the concept of the Postal Service collecting the DAL information. Did you notice Witness Kiefer's testimony where he said that they have begun this?

A Yes. I was very pleased to see that.

Q So perhaps a year from now, we'll all know more than we do now.

A Yes. We can get on to better things.

(Laughter.)

Q Well, it shouldn't be this hard to come up with an estimate, and we're all struggling with it. But I thank you for your clarity on where you came up with the number. I want to just see how your revision to the number of DALs changed the cost of letters.

A Okay.

Q These are summarized on the next page.

A You'll have to point them out to me. This looks a little confusing.

Q Yes. I'm sorry.

A That's all right. Just point them out to me.

Q If you look at the first section of this cross-examination exhibit, it says "letter unit costs," and it starts with the USPS number of 6.665, which may be based on the mishmash that you described before, --

A Yeah.

Q -- then the number, 6.651, which is in your table, but as you say, that isn't a change; that just flows through some other source. When Kelley came up with his second table where the DALs were given to flats, not letters, correctly, then he came up with a 4.137-unit cost -- this is, of course, as we said before, city carrier street time and rural carrier

costs only -- Correct?

A It's delivery costs. I may be repeating. It's city carrier and rural carrier costs, --

Q Right.

A -- total of both, plus the burden --

Q City carrier straight time, though. Correct?

A Test year. No. It's total city carrier.

Q That's how he labeled his exhibit. That's why I'm --

A Okay. I'm sorry. Let me explain what I think it is.

Q Thank you. Yes. Go ahead.

A On those tables, that's a unit delivery cost, test year, including all test year city carrier costs and out of office and all rural costs with all the piggy-backs, all the burdens, everything, divided by the test year RPW volume numbers. So it's a test year unit cost, total delivery, but excludes post office boxes, highway -- star route deliveries and that sort of thing, general delivery.

Q You know, let me accept that answer.

A Okay.

Q Frankly, I noticed the way you put it in your testimony. You used those delivery costs, and

you added mail processing and came up with total.

A Right. I'm adopting a construct that we've been using for years which does that, mail processing and delivery, delivery meaning those costs that I just told you about.

Q I'm not challenging that at all.

A I just want to be sure it's clear.

Q It is, and I appreciate that. Thank you. But with that definition of what delivery costs we're talking about, carrier costs we're talking about, Kelley came up with 4.137 for letters, based on 3.375 billion DALs. Correct? Do you accept that?

A I'll accept it. Like I said, I don't have all of that in front of me.

Q Sure. And that when you increased the estimate of DALs to 4.315 and made no other changes, you came to a corrected letter unit cost of 3.69. Correct?

A Let's see if I can find it.

Q The reference is to page 12 of your testimony in the cross-examination exhibit.

A 3.629, yes, sir. That's the number.

Q Okay. Good, good. So that was a decrease over the Lewis number of .508 cents per piece per letter.

A Mr. Kelley's number, yes.

Q Now, let's just flip that and look at the flats. The Postal Service, Mr. Kelley, came up with a unit flat cost of 3.191, and I'll just ask you to accept that, the number in your chart of 3.197, and we know that was not a deliberate change, that his unit costs for flats were 4.163 cents, and that was based, again, on his 3.375 billion DALs. Correct?

A Yes. His number was based on that figure.

Q Okay. And then your correction to increase the number of DALs to 4.315 billion gets the flat unit cost up to 4.358 cents. Correct?

A Uh-huh. That's the right number.

Q Okay. And so that increases the number over Kelley, by my math, by almost two-tenths of a cent, .195 cents. Correct?

A Yes, sir.

Q Okay. And when you look oat the letter-flat differential -- you see at the bottom, we just put the numbers together and say flats minus letters, and in the first column, the erroneous Kelley mishmash approach shows an anomalous situation where letters cost three cents more than flats. Do you see that? That's where the DALs are charged to the letters.

A That's what you're calling the "erroneous

approach."

Q Uh-huh.

A Okay.

Q The Kelley erroneous approach. He didn't endorse it. He said -- what we've already discussed.

A Illustrative.

Q Okay. Yes. That's a good way to say it. And then the second column, Kelley's approach was to demonstrate a 0.026-cent letter-flat differential where this time flats were just a tiny bit more expensive to handle than letters. Correct?

A Yes.

Q And then when you changed the DAL estimate up to 4.315 billion, adding in almost a billion DALs, the letter-flat differential grew to .729 cents. Correct?

A That's correct.

Q Okay. And that's, by my math, 28 times what Witness Kelley estimated, just by switching the DALs.

A Okay.

Q Sound about right?

A I'm not going to do the math right now.

Q Sure, sure.

A I'll accept yours.

Q Okay.

A You said 28 times?

Q Twenty-eight times. It's .026 cents, which is -- and it went up to --

A Okay. Right.

Q -- .729 cents.

A I got it. I see the way you're doing it.

Q I just multiplied the letter-flat differential under Kelley versus you, so it went up 28 times. That was my reference.

And the only thing that changed between those two numbers was putting an extra billion DALs in. Correct? Not quite a billion.

A Roughly.

Q Roughly. The interesting thing that I just want to make sure you and I have the same understanding of why something happened, if you just go to the second page where just the numbers are pulled out, and we see the change in the letter cost as being half a cent, and the change in the flats cost going the other way, letter cost coming down half a cent, and the flats cost going up two-tenths of a cent, that's a function of the relative volumes, is it not, of letters and flats?

A Okay. Start again. What numbers are you comparing to get the letter differential?

Q Well, maybe the best way is to go back to page 1. I'm sorry. Maybe this is the best place. It's the last line of each of the first two sections. The first section is letter unit costs. The last line, it says "Crowder demonstrates decrease in letter costs over USP estimate of 0.508 cents."

A So that's five-tenths of a cent that you're talking about.

Q Right. So the cost of those letters went down half a cent. Correct?

A Yes.

Q Okay. And if you look at the last line of the section on flat unit costs, you demonstrated, taking your number versus Kelley's number, flats went up two-tenths of a cent roughly, .195 cents. Correct?

A That's correct. I'm assuming your math is correct.

Q Sure. You're just accepting.

A Yeah.

Q Yes. All I'm trying to get to is why letters come down half a cent, the flats only go up two-tenths, and the reason is relative volumes, is it not, that there are so many more flats in the system than there are letters that that's the way this works?

A Oh, yes. That's exactly right.

Q And that's the only reason it works that way. Correct? It's the letter-flat volume. In fact, it's assuming more flats in the system than letters.

A I'm not sure exactly what you're asking. Are you asking why one decreases more than the other increases?

Q Yes, yes.

A Is that what you're asking?

Q Yes. Exactly.

A Yeah. It has to do with that and whatever else is embedded in the spreadsheet assumptions, yeah. That's exactly it.

Q And if there were the same number of letters and flats in the system, one would assume that if one number went up, and the other came down, they would go up and down by the same amount. Would that not be the normal assumption?

A That sounds about right. I guess I would want to do some examples to be sure of that, but that's about right. What you're getting is that one goes up less than the other goes down, --

Q Yes.

A -- and the big reason for that is that there is less letter volume over which to spread those costs, and that's the majority of the reason, but

there are other things that are embedded in those spreadsheets that might have an impact on it also.

Q Anything you can think of offhand? I'm not sure that's a fair question.

A If you looked at those spreadsheets, you know what I'm talking about. I'm not sure I would want to pinpoint any one particular thing, but I would not be terribly surprised if that was the case. DALs are a little different than letters.

Q Thank you. Let me ask you to look at your testimony at page 13. This box at the top of page 13; this is PRC costing. Correct?

A Yes, sir.

Q Okay. And then what threw me for a second was that the column headings had "USPS" in it.

A You're right. That's a leftover from a spreadsheet that I didn't completely correct. I do apologize. The first column are the adjusted mail-processing costs from K-107, which is the PRC version. It's just USPS-K-107. The second one; I believe it's K-101, which is the PRC version of delivery costs. So this second column that says "delivery" is really USPS-K-101, if I'm correct, and that also is in our library reference.

Q But really, both of these are the Postal

Service estimates using PRC costing, so you're not entirely wrong in your headings, but it is PRC costing. Correct?

A Yes, sir. That's exactly what it is. It's the PRC version of costs, --

Q Okay.

A -- with some adjustments that I made to reflect various things, and I've mentioned that.

Q Exactly. You don't have to reiterate those. We understand that this is not just the Postal Service.

A Right. There are modifications in here that reflect what is really occurring.

Q Right. I understand. And, again, this is a small thing, but the first column on mail-processing costs, --

A Yes, sir.

Q -- you know, there's a variety of numbers that come out in any one of these cases, and we're not sure we're looking at the most current, but is that column tweaked from the Postal Service number?

A No, sir. I can tell you exactly where that comes from, --

Q Okay.

A -- if you would just give me a minute.

Q Take your time.

A This comes from K-101, and it's Table 9, and what I did is I copied Table 9 from K-101, and K-101 had the comparison, USPS version versus PRC version, and so this is directly from K-101. I have not changed any number, but it is K-101. I don't remember whether K-101 was changed any way during the course of the case, but if it was, I tried to catch all of those changes.

Q It's very difficult, I know.

A Because there's been lots of revisions. You can just copy it right out of the spreadsheet, and it shows both PRC and USPS versions, and that's where those mail-processing numbers come from.

Q Okay. So the changes that you made are not in the mail-processing area, but they are --

A Correct.

Q -- purely in the delivery column. Correct?

A I did not touch mail processing, not in this one, and this, I want to point out, is the adjusted work shared. These are adjusted to make all of them look as if they are zero drop ship. I believe this is the version of that.

Q Drop-ship adjusted?

A These are drop-ship-adjusted, mail-

processing costs.

Q Exactly. Thank you. And on that chart, when you look at the right-hand column, adding the mail processing to the delivery, this, as you say, is the convention we follow to develop costs for rate-making purposes, and at the saturation level, this is where you develop the letter-flat total cost differential this time, like, we used to talk about carriers, but now this is total cost of 1.483 cents. Correct?

A I think I wrote that down, yeah, 1.483.

Q On the page before, you discuss it. It's the difference between the saturation letter and the saturation flat number in the far-right-hand column --

A Yeah.

Q -- of the chart at the top of page 13.

A Yes, sir.

Q Okay. Could you look at your testimony on page 1, please?

A Page 1?

Q Yes. Lines 6 through 9. It says: "Mr. Mitchell contends that the Postal Service proposed ECR letter-flat rate differentials are too low and should be increased, even to the point of applying a cost-average markup well above 100 percent of the letter-

flat cost differential." Do you see that?

A Yes, sir.

Q Okay. And on page 1, at line 21, you specifically talk about the letter-flat rate differential as being something that exists as a basic rate level. So when I ask you a couple of questions here, I'm focusing on the basic rate level. Okay?

A What did you say I contended?

Q It's not what you contended.

A Okay.

Q You discussed the basic rate level and the letter-flat differential at the basic rate level. You're discussing what Mitchell said, --

A Yes, sir, I am.

Q -- and the context is the letter-flat differential, and you talk about the basic rate level and what he said.

A Yes, sir.

Q Okay. So I'm just focused on the basic rate level at the moment.

A Okay.

Q Just so the record is clear, can you tell me what the pass-through is of the letter-flat differential recommended by the Postal Service at the basic rate level?

A I believe that the Postal Service recommends that basic rate letters pay the same rate as basic rate flats.

Q And so --

A So if there is any differential, then it's a zero pass-through. My recollection is the Postal Service version of costs shows that basic rate letters cost more than basic rate flats.

Q I'm just trying to get at what the pass-through is requested in this case and, for example, what it is now.

A There is no pass-through. There is no rate differential.

Q And, indeed, if we look at the rate schedule, there is a basic rate -- I've got these here --

A Are you looking at the rate schedule?

Q Yes.

A I have it here, too, if I can find it.

MR. OLSON: I'll hand these out so we can have it. Mr. Chairman, this is Rate Schedule 322, as proposed by the Postal Service, which is for the carrier route subclass.

(Pause.)

MR. OLSON: You have the rate schedule

there.

THE WITNESS: Yes, sir.

BY MR. OLSON:

Q If you would just take a look at the basic piece rate, the minimum piece rate, proposed for letters, -- that's the 20.4 cents -- Correct? --

A Yes, sir.

Q -- and for nonletters, it's 20.4 cents --

A Yes, sir.

Q -- for a zero pass-through.

A Correct.

Q Okay. And just as another illustration of an actual mailing, if you have a three-ounce letter, let's say, that's under the break point, a flat that wants to convert to a flat or a letter to a flat, it's facing the same rate whether it's a letter or a flat if it's three ounces. Correct?

A If the mailer wants to change the shape, yes.

Q Let me talk to you a moment about what Mr. Mitchell talks about as a default solution having to do with marking up cost differences. Do you recall that language in his testimony at all?

A No. I would not like to characterize it without looking at it. What language are you talking

about?

Q Do you have his testimony with you, by chance?

A I will get it out in just a minute. What page are we talking about?

Q 83, line 11.

A Okay.

Q And there is where I believe he is talking about thinking of letters and flats as separate products, and he says, "In fact, if a default solution exists, it would probably be one of equal percentage markups, although economic theory would suggest that the solution should be tempered if the cost elasticities are high." Do you see that?

A Yes, sir.

Q Okay. Do you recall there was an interrogatory from Advo to Mr. Mitchell, No. 8? I don't know if you have them, but it's just one sentence I'm going to read to you, if you don't mind. You did review his responses to Advo interrogatories, I'm sure, at some point.

A At some point. I haven't recently.

Q Well, here, he said, "Factors that could argue for an over-100-percent default pass-through to move downward toward 100 percent would be," and then

he lists several factors. I don't know that you recall that answer.

A Yes, I do.

Q You were here, I think, when both Dr. Haldi and Mr. Mitchell were cross-examined in the hearing room.

A Yes, I was.

Q When Mr. McLaughlin cross-examined Mr. Mitchell, he talked about a default solution. It's at 5414 of the transcript, which I'm not expecting us to look up. The concept of a default solution; do you recall Mr. Mitchell talking about there being a default solution which has to do with marking up cost differences?

A If you'll refresh me, I would appreciate it.

Q Well, the reference on page 83 is the main one I'm referring you to, where he talks about equal percentage markups, and that's basically talking about marking up cost differences, is it not?

A I understand that what he is discussing here are pass-throughs and cost and rate differentials. I understand that. Truthfully, even after discovery, I was still a little bit confused by exactly what he was proposing. So I understood that he was proposing, and this is just my understanding of everything I could

pull together, was that, on page 87, he was proposing 100-percent pass-throughs on all of the differentials, and on pages -- let me see if I can find it -- 82 and 83, he was proposing at the letter flat with the basic rate level, he was proposing that the pass-throughs be roughly equivalent to the cost coverage for ECR. Beyond that, I was confused about what else he might want to do to modify those two points.

Q My question doesn't really have anything to do with his recommendation; it has to do with his observation as to there being a default position in postal rate making about marking up cost differences, and that's what the concept of a default solution, I think, goes to, if you mark up cost differences, or if you don't mark up cost differences as a regular matter. Can you give us any thoughts, after having been at this for a while, as to whether the default position is to mark up cost differences that are observed in the rate structure?

A I think I have given you my best shot at it in the sections of my testimony where I discuss the conventional approach and then separately the approach where you consider these as different products. I'm not sure that I can add a whole lot more to that, especially because it looks like you're asking me

within the context of Mr. Mitchell's construct, and I'm a bit reluctant to try to interpret what's appropriate within his construct.

Q Okay. Let me take it out of that construct and create a new and artificial and simple one, which is simply to say that I think you and I started in the same year, in R77-1, in these cases, and in all of those years we've dealt with lots of cost differences and lots of rates based on those cost differences in all sorts of classes of mail, and you've put in testimony on a number of postal products. Correct?

A Yes, sir.

Q And I'm trying to get to whether there, you know, is a default position -- now that's the term that Mitchell used. I actually looked it up, and the definition I had was "a situation or condition that obtains in the absence of active intervention." Unless you change it, that's what it is. Is that definition okay for us to use in these questions?

A That's fine, but if what you're asking me is what I think is appropriate for pass-throughs. I don't think that what I think is appropriate is really a default position because I think a default position is if no one says any different, the Commission is going to make its selections.

Q Well, let me tell you how I'm thinking about this and see if you can walk through this with me. Let's talk about first class and rate-design principles there and see what we can learn for ECR. If you have a letter that is just under an ounce, and you put a few more enclosures in, and it just goes over an ounce, the rate increases by 24 cents. Correct?

A It's subject to the additional ounce rate, yes.

Q So the total rate goes from 39 to 63, and that's an increase of 61.5 percent. I'll ask you to accept that number.

A Okay.

Q Do you have any intuition from your years of looking at these that leads you to believe that the cost difference is 24 cents?

A I don't know very much about first class.

Q If you want to give the same answer that's okay, but do you think that it might be highly likely that that 24 cents includes a markup on the cost difference?

A I know it does. I know the additional ounce rate in first class includes a markup.

Q A substantial markup?

A I don't know. I can't tell you that.

Q Okay. And for parcel post, for example, you have zone charges and weight charges. Are you aware of the fact that those are marked up in rate setting? I don't know if you've worked in parcel post.

A Not recently, to tell you the truth, and I truly cannot remember. I wouldn't be surprised if they are marked up a bit. Somewhere you would have to get the markup, so I would guess that in each of those cells there is some coverage included. There would have to have been.

Q There are some adjustments for anomalies.

A I don't know any more about it than that.

Q I'm just trying to get at this question of the default position. And in priority mail, where I spent some time, are you aware of the fact that the subclass's markup is put on the cost differences based on weight and distance?

A No, sir. I don't know anything about priority.

Q Express mail?

A No.

Q Okay.

A I've looked at them, but I've never really gotten into it.

Q It's remarkable how we specialize in these things in different products. In standard mail, what I'm trying to get at is if you think we don't have ample precedent for the notion that cost differences are routinely marked up unless there is a good reason not to do it. Is that a reasonable statement?

A Cost differences are routinely marked up.

Q In rate setting.

A In standard mail, I don't think you can give it that kind of broad brush. In standard mail and ECR, the markup of cost coverage is at the subclass level. Now, I'm not quite as familiar with standard mail, but my understanding is that most of the other cost differences are truly considered as if they are work-sharing related and, therefore, adjusted, so they are treated as though they are work-sharing-related differences.

In no case that I know of now in standard or in ECR does the Postal Service or the Commission look at total real costs for each kind of mail and then look at the differences between them. What they are looking at are work-sharing or shape-related differences, and the convention is that they are treating those as if they are work sharing; and, therefore, efficient component pricing is applied.

Q Do you have a position as to whether you believe that a letter-flat differential is a component of work sharing? Didn't your testimony speak to that? Didn't you say that the choice of entering -- I may be thinking of someone else's -- the choice of entering a letter or a flat is not work sharing if they are simply different?

A I don't believe I said that.

Q I apologize.

A That's okay.

Q I haven't looked at the testimony since Thursday.

A There are times when a mailer may change his product to get into, you know, a category where he gets lower rates, and I know that happens. It doesn't happen a whole lot, but I know it happens. But basically, there are nonwork-sharing differences between letters and flats. I'm not going to deny that, and I think that, you know, we've kind of accepted -- for purposes of what I've done, I've accepted Mr. Mitchell's argument that letters and flats are different products.

Q If the cost difference between letters and flats cannot be described as a cost difference based on work sharing, -- now, admittedly, just general --

then I'm trying to get at why the letter-flat cost difference should be sort of an exception to the rule or -- that cost damages are marked up frequently, often, and perhaps regularly and perhaps routinely perhaps as the default position at the Postal Service. We're not talking about work sharing; we're talking about other cost differences, such as the letter-flat differential.

A If they are treated as separate subclasses, they are separate products, and you know what your total costs are for that, then, yes, it's appropriate to mark them up based on their costs, and if it's a different subclass or product, then it's appropriate to do that.

I think what you're getting at is, why can't we do that within the ECR subclass?

Q Uh-huh.

A You know, what you're pointing out is there are problems with the ECR subclass. I'm not trying to deal with all of those things. There's a whole lot of things to consider, and one of those interrogatory responses that Mr. Mitchell gave identified some of those things that you ought to be considering, but that's not the way we've been doing it. All I'm trying to say is this is the way it's done now. If

you want to treat them as separate products, then here is the right way to treat them as separate products.

And further, within the construct that we now have of the ECR subclass and the way the rate-making algorithm is done and the way all of these cost differences and pass-throughs and all of this stuff is done, if you try to tweak some of that, hoping to make everything correct down at the bottom where ultimately all of the decisions impact, it doesn't work. It just doesn't work that way. Something more basic has to change. So you can't tweak something at the basic rate level and hope that it's going to make a difference and it's going to do the right thing at the saturation rate level, and that was really the gist of my discussion there.

I'm very reluctant to give you a definitive answer on pass-throughs and coverages and markups because there is just too much that has to be considered, and I just haven't dealt with all of that. I'm just trying to address what I think Mr. Mitchell said that was important to this case, and what I interpreted him to say looked to me like it was going to be a really big impact at the saturation, high-density level and would go in the wrong direction.

Q Okay. Let me change topics, --

A Okay.

Q -- mercifully, and ask you to take a look at page 2 of your testimony, and at line 9, you quote the Commission, in R2000-1, as saying, "As the pound rate is supposed to reflect the effective weight on costs, passing through a substantial portion of the ECR-letter-flat differential amounts to double counting of the effect of weight." Are you with me?

A Yes, sir.

Q Okay. And I want to use some illustrations to discuss this issue and try to get at it, and I want us to begin with thinking about a three-ounce letter that converts to be a three-ounce flat. The mailer decides to change the shape of the piece. I'm going to ask you to stay with me at the basic level.

A This is basic rate, ECR basic rate?

Q Exactly. Yes.

A Okay.

Q Now, when this piece converts, by definition, the weight doesn't change. Right? Same piece. A different shape but same weight, we're postulating.

A By definition, that's what you're saying.

Q By definition. And then we discussed before how the rates were, and you agree with me that it

doesn't -- well, it doesn't pay a pound rate. Correct? It just pays the minimum per-piece rate if it's a nonletter. It doesn't pay a pound rate if it's a letter; it doesn't pay a pound rate if it's a nonletter. Correct?

A At three ounces, that's correct.

Q Okay. And under the Postal Service's proposed rates, the rate doesn't change before or after if it's a letter or a nonletter at three ounces. Correct?

A That's correct.

Q Now, I'm going to change the assumption a bit and postulate that there is a cost difference between letters and flats, and the total difference is two cents, and unlike the Postal Service proposal, we choose to recognize that in rates at the basic level at the moment and 100-percent pass-through. So let's assume we have equal -- let's not get into what we did before -- we have equal volumes of letters and flats, -- okay? -- and the minimum piece rate of a letter gets set at 19.4, and the minimum piece rate for a flat comes out at 21.4.

A Hold on just a minute.

Q Sure. It was 20.4 --

A It's 19.4 and --

Q The letters go down a penny to 19.4; flats go up a penny to 21.4. Okay?

A Two cents' difference.

Q Yes. And we're assuming that that's a cost-based rate difference -- a cost difference we choose to recognize in rates.

A The cost difference is two cents, and the rate difference is two cents.

Q Uh-huh. Now, I'm trying to get to the point you're making in your testimony and why you quote the Commission about the double counting that you later call double charging. Let me see if I understand your point. Are you saying that the reason the flat costs more than letters is not just because it's flat shaped but because nonletters are heavier than letters, as a class, the average weight?

A The unit cost for letters and the unit cost for flats that are used to determine the cost differential are calculated as follows: For letters, it's all letter cost divided by all letter volume, and for flats, it's all flat cost divided by all flat volume. So the unit costs are averages for all of the characteristics you find in flats and for all of the characteristics you find in letters. On average, flats cost more. On average, flats are flat shaped,

and the letters are smaller, have a smaller dimension, and both of those characteristics, on average, are reflected in the unit cost for letters and the unit cost for flats.

Q And so the measured two-cent cost difference is not just based on shape, you would argue.

A It's based on all of the differences in characteristics between letters and flats.

Q Importantly, among those characteristics is weight, that flats might have a higher average weight. Would that not be your argument?

A Yes.

Q And can you identify any other cost drivers that would come into play besides shape and weight?

A There may be some, but those, I think, are probably the big ones. Those are the real big ones. You're talking about mail characteristics?

Q Any characteristics that can affect cost.

A The mail characteristics obviously cause differences in processing costs, and so everything kind of flows from the mail characteristics.

Q Okay. To help clarify what you're saying, we went to the billing determinants in Library Reference page 77 and pulled the page on ECR and put some numbers in the column on the right here, and I

just want to show these to you.

A Okay. Where did this come from? This is from the billing determinants, Library Reference --

Q -- page 77.

A -- page 77.

Q There were two sheets, G-2, page 1, and G-4, page 1, and this is page 1 of 2, and it simply -- the only reason I'm going to use this is to get some average weights.

A Okay.

Q I'm trying to really grasp what you're saying, and I think if we use these average rates, it's going to help us discuss it. If you take a look at the far right, this is an addition to the billing determinants, but it puts in there an average weight of different pieces.

Let me just point out a couple where the arrows are. The average weight of a basic nonautomation letter -- I'm going to ask you to assume that these numbers are right in the right-hand column -- is .95 ounces.

A Uh-huh.

Q The average weight of a basic nonletter is 3.43 ounces. Do you see that one?

A Yes, sir.

Q And the average weight of a minimum-per-piece nonletter is 1.8 ounces.

A Okay. 1.87. Where are you?

Q I'm sorry. 1.87 ounces, yes, in the right-hand column where the three arrows are. So .95, 3.43, 1.87; those are the three unit per-piece weights that I'm going to discuss with you.

I want to add a disclaimer and assume it away having to do with the residual shape surcharge. The figures include the weight for parcels that pay the residual shape surcharge, but it's very small, so we're just going to assume that's not involved here, if that's okay.

A And you don't know --

Q This is complete. This includes it. We didn't make a correction for it. Actually, we ran the numbers and saw the numbers changed so small, it wasn't worth --

A That's fine.

Q -- you had to go to more than two decimal points to see the change in weight, so we didn't fool with it.

Now, let's take a three-ounce piece, and we're going to talk about the conversion of a three-ounce piece from being a flat -- I'm sorry -- a three-

ounce piece when it converts to being a flat, its rate increases two cents. Remember in our new rate structure?

A Yes, sir.

Q Okay. And I want to try to understand your argument about this double-counting issue using this three-ounce piece as an illustration. When it was a letter, it was paying a rate that was suited for an average weight of .95 ounces. Correct? The rate is designed --

A Its rate was designed on the average for all letters in its category.

Q Yes. And in this case, it's .95 ounces. When it converts to being a flat, are you saying it's paying a rate that's better suited for a piece that's an average of 3.43 cents, as we see here?

A 3.43 -- you're talking about 3.43 ounces?

Q Ounces. I'm sorry.

A Well, actually, what I'm talking about is not one specific piece because it would be very unusual to have a rate that was precisely developed for one individual piece. These rates are for the averages. So by definition, when you average, you have a unit cost. Say you have a unit cost for flats, and the average flat weights -- what have we got here?

-- 3.43 ounces. Okay. By definition, you've got some flats that are going to cost less than that and some flats that are going to cost more than that, and what it appears to me that you're suggesting is that this particular piece that's just been converted to a flat is one of those where it's going to cost less than the average, but it is going to get that rate based on the average.

Q I've actually got seven of these illustrations, and what I'm trying to do is take different scenarios of different weight pieces and conversion, nonconversion, trying to test your theory of this double counting.

A Okay.

Q So I'm trying to get at the heart of what your problem would be about recognizing the two-cent cost differential in rates at the basic level, and I'm suggesting that -- I don't want to put words in your mouth; I'm just trying to understand your point so we can deal with it. You seem to be saying that when a letter converts to a flat, even if it's the same weight, it's a three-ounce piece -- if it's a letter, it's a three-ounce piece, if it's a flat -- that all of a sudden it's going to face a very different rate, two cents more in our new rate structure, and that

that's wrong for some reason to do that. It's wrong to do it, and one of the reasons has to do with this double counting that you're getting at. You're saying the two cents reflects the different shape because now it's a flat, and it used to be a letter, and you said the other reason you could think of is that the weight is different, and I'm trying to focus this on the weight to see how much that affects why you don't want to pass through the costs, why it's unfair to set rates this way.

I'm going to stop talking and ask you if any of that makes any sense to you.

A I'm trying to follow it, but I want to be real clear that I did not say that it would be wrong for this three-ounce letter that had now become a three-ounce flat to pay the additional two-cent differential. I never said that. If it's now a flat, it may be a low-cost flat, but it's got to pay the flat rate. If it's rated as a flat, then that's the rate for the flat. Its cost will be included in the mix of costs from which the average flat cost is produced.

It's just like any other rate. We have this problem with saturation mail. When you average things, some of it is lower than the average, and some

of it is higher than the average, and this poor, pitiful mailer just got, you know, thrown into a high-average-cost group, even though his cost is not that high, and it just happens that way.

I'm not saying that's wrong. And you can't just pick any one piece and say, what about this piece, what about that piece, because I'm talking about averages, and that's how our rates are set. That's all I have to work with.

Q Did you say a second ago that you didn't have a problem in recognizing a cost differential between letters and flats at the basic level in rates, if there were a cost differential, to recognize it in rates?

A I'm talking about the example that you just gave me. You gave me an example, and that example, by definition, had a rate differential and a cost differential. I don't want that to be construed as something that I'm agreeing to for our current set of ECR rates, which is the basic rate for letters and the basic rate for flats being equalized. I'm not --

Q I don't want to be unfair either. That's why I asked. I think perhaps you were just discussing my hypothetical, but it sounded like you said you didn't have a problem with this as a principle as

opposed to working within my construct.

A I can't remember what I said there. I don't have a problem with that poor, pitiful mailer having to pay two cents more because he has just turned it into a flat. I have no problem with that.

Q Okay. Well, then outside the context of my assumption that we're going to have a two-cent cost differential between letters and flats that we're going to pass through, do you have a position as to whether a demonstrated cost difference at the basic level for ECR letters and flats should be reflected in the rate structure at 100-percent pass-through?

A I've thought about it. I haven't studied it. I don't know a lot about those types of mailers and what would be involved if you made that, and I know that there is this postal policy of equalizing those two rates. So I'll have to defer to somebody. The party that knows all of that and has made that decision; that's what I'm going to defer to because I just don't have enough information on it.

Q I didn't want to quote you in a brief and surprise you. I just thought I would give you a chance to explain what I thought you had said. And I know you've said that you can't discuss the principle quite as well with respect to specific illustrations,

but I want to ask you if you could try with respect to this hypothetical, this hypothetical, three-ounce piece.

I want to go back to my initial question, now that we've gotten a lot of other things out of the way. If it was paying a rate that was suited for .95 ounces, and now it's paying a rate suited for 3.43 ounces or --

A -- 1.87.

Q -- or 1.87 -- thank you -- in the case of a basic, piece-rated nonletter, is that a fair description of what you believe to be the unfairness of reflecting in rates cost differences between letters and flats? I'm trying to get to the double counting and how that applies to my three-ounce letter becoming a flat. Is it involved at all?

A I think it's getting a little mixed up. We don't know how much of the cost difference is weight and how much is shape or any other piece-related characteristic, for that matter. It may not be shape, but it might be something else about the piece. What we have now is we have rates where there is a piece rate up to a break point, and we have a pound rate above that. Now, I'm really saying that if there is weight -- here is a different way of looking at it.

You can either have no shape- or piece-related difference at all. Then there would be no piece rate differential, none whatsoever, and all of it should be based on weight. All of the difference should be recovered through the pound rate or vice versa, which is it's all shape related; and, therefore, you don't need a weight-related rate element. You just don't need it. It's somewhere in the middle there is where it probably is, and I can't tell you where, but if you're recovering weight-related cost differences in the piece-rate differential, and you're also recovering them in the pound rate, it looks to me like you're overrecovering them.

Actually, you can see it when you look at these things as individual products, looking at the high-density saturation letter product versus the high-density saturation flat product. You can see it because the flat product, it's got a higher cost, but it's got even a higher coverage. It's making a whole lot of institutional cost contribution, and that's because it's double recovering some portion of weight or maybe all of weight. I can't tell you. But this is an average thing. You can't really look at it as an individual piece.

CHAIRMAN OMAS: Excuse me. If I can interrupt at this point, I think maybe we should take about a 10-minute break, our morning break, and come back at eleven-fifteen. Mr. Olson?

MR. OLSON: Yes, sir.

CHAIRMAN OMAS: Thank you.

(Whereupon, at 11:05 a.m., a brief recess was taken.)

CHAIRMAN OMAS: Mr. Olson?

MR. OLSON: Thank you, Mr. Chairman.

BY MR. OLSON:

Q Ms. Crowder, I want to just direct your attention to the cross-examination exhibit that I handed you with the billing determinants in the right-hand column and just clarify that the average weight of the pieces includes commercial and nonprofit. I don't know if that affects anything, but I just wanted to make sure it was clear.

I'm going to ask one more question on this and then move to the next hypothetical, which is, when we were talking before about the degree to which the minimum-per-piece charge might reflect weight, and I believe you said you couldn't tell us how much it was, do you have any observations on the degree to which the minimum-per-piece charge reflects payment for

weight-related costs?

A I can speculate a little bit. My speculation is that the majority of the difference between unit letter cost and unit flat cost, at least at the high-density saturation level, is based on the piece and shape characteristics and not on weight, which means that it's not really the letter-flat differential that's the problem. What it means is the pound rate is a big problem, and that's really where I think the problem is.

Q The pound rate is too high?

A The pound rate is too high. We've gone over that and over that in multiple cases, --

Q Yes.

A -- and it's a he-said/she-said kind of thing.

Q We may resolve that some day but not today. Thank you. I just wanted to clarify what your thought was.

Let me ask you to change thinking with me here a minute on my hypothetical. This time we're not focusing on pieces that convert from being letters to flats, but we're going to assume, as some of the Advo interrogatories to Mr. Mitchell assume, that different companies use different products and that they can't

readily convert between letters and flats. Do you recall those interrogatories?

A Yeah. I recall those, yes.

Q Okay. So let's just look at letters below the break point, all letters below the break point, which in my example before were paying 19.4 cents. Correct? Do you recall that?

A 19.4 cents. Okay.

Q Do you remember it was 19.4 and 21 -- okay. And the flats below the break point that are paying 21.4 with that two-cent differential, and we're not discussing conversion; we're just talking about the different products, and if we look at these billing determinants, the letters weigh, on average, .95 ounces, and let's assume that that's a fair or reasonable rate of 19.4 cents for that weight. Okay? We're just going to assume that that is the definition.

Flats below the break point, they are paying 21.4 cents, and they are the ones that weight, on average, 1.87 ounces.

A 1.87. Okay.

Q We're talking about this time basic --

A Right.

Q -- nonletters that are piece rated. Is your

concern that the flats that weigh 1.7 ounces, on average, are paying a rate suited to 3.43? Now, I know we discussed this in a different context a minute ago. You talk about averages, and you have to take it the way you are, but let me just -- and if the answer is no, just tell me, and I'll move on, but are you concerned that the flats that these flats weigh 1.7 ounces, on average, and they are paying a rate suited to 3.43 ounces?

A I'm not sure that I can boil it down quite like you're saying it. The concern is flats in general are paying the piece rate differential plus the pound rate. Not all flats are paying the pound rate, but some of them are, and that combination is overrecovering costs. That's the best way I can say it.

Q When you say "overrecovering costs," you're not saying literally double the recovery of costs; you're just saying something more --

A I don't know where it is, to tell you the truth. If you put 100-percent pass-through on the letter-flat difference, and then you're trying to recover it again in the pound rate, then, yes, you are overrecovering, double recovering, whatever the weight-related cost is.

Q Okay. But you're not double recovering everything; it's just the component that's weight related. It's overrecovery, not double recovery.

A Wait a minute. Hold on. Hold on just a minute.

Q Okay.

A You have two unit costs that are just averaging a cost, a letter unit cost and a flat unit cost, and there is a cost difference. Say it's two cents. Now, if you make those flats pay the two cents more than the letters, and then you're also making them pay a pound rate on top of that, it sounds to me like you're overrecovering more than your two cents, depending on how much of the pound rate is charged.

So yes. I mean, if the total difference is two cents, then the rate structure should be, and it's all piece related, then the rate structure should be the 19.4 cents for letters and 21.4 cents for flats and zero for any pound rate, and that's what that structure ought to be. It's just that simple. The two cents; you can only use it one way. It's either going to be a pound rate, or it's going to be that letter-flat piece rate differential. That's all you've got.

Q Let's come up with an illustration that

deals with just the pound rate, not the minimum piece rate charge. This is the last illustration.

A Okay.

Q This has to do with a flat that weighs six ounces, and I want to look at the rates that are actually being proposed in the proposed in the chart that I gave out before. In Rate Schedule 322, it says the basic flats pay a piece rate of 7.2 cents and a pound rate of 64.3 cents. Correct?

A I'm looking for it. 7.2 cents, and the pound rate is 64.3.

Q Okay. So the six-ounce piece is paying that piece rate and that pound rate. Correct?

A Yes, sir.

Q Okay. And if we have cost-based rates in ECR, the 7.2 cents is covering piece-related costs, and the 62.4 cents is covering pound-related costs.

A That should be the intent. That should be the intent, yes.

Q Can you tell me how you see the development of the 7.2-cent piece rate that that piece is paying reflects the weight of those pieces? How in the rate design, how do we get to the point where that 7.2 cents reflects weight charges as opposed to piece charges?

A In the rate design, at the break point, the per-piece rate is the same as the per-pound rate. What I'm saying is whether at 3.3 ounces the piece is charged only on the basis of pieces or it's charged as a pound-rated piece -- let me say it a little bit better.

Q Remember, we're only talking about six-ounce pieces in my question.

A Okay. But I need to explain what's going on. In the rate structure, there is a break point of 3.3 ounces, and at 3.3 ounces, a piece could be charged at the piece rate, or it could be charged at the pound rate, and either way it's charged, it's going to be the same price, which means that, at 3.3 ounces, with the 7.2-cent-per-piece charge for pound-rated pieces, the total weight differential is what is calculated.

I can't remember what the pass-through is, but say, just for simplicity, say that rate differential is 100 percent of the cost differential. Okay. So if you're paying a piece rate, and you're a flat, you're already covering all of your costs, and if you are at 3.3 ounces, and you're a pound-rated piece, you're already paying all of your costs. Now, if you go above 3.3 ounces, then you are paying a

pound rate, which is something in addition to, but you've already covered your costs when you got to 3.3 ounces. On average, you already covered the flat cost. You already covered it.

Q Can I just focus back on a six-ounce piece for the question?

A So what I'm saying is the per-pound charge for the difference between the six ounce and 3.3 ounces -- what is that? That's 2.7 ounces -- the pound rate for the 2.7 ounces is overrecovery. When you assume that there is 100-percent pass-through of the cost difference between letters and flats, then the pound rate is completely extraneous. It overrecovers, and any charge between the 3.3 ounces and six, which is 2.7 ounces times whatever the pound rate is on a per-ounce basis, that is overrecovering.

Q Do you think that the 7.2 cents piece charge is the right level, or is that too high because it recovers weight-related costs or too low because it doesn't recover all of the piece-related costs?

A I think I've already answered that by saying that I would have to speculate because I don't really know what's piece related versus what's weight related.

Q Okay.

A My speculation is --

Q Let's not speculate. Let's just go on. Do you have a recommendation as to -- I guess this gets us into the same area. Let me just move on to your testimony at page 2 again.

On line 17, you say, "Alternatively, if the pass-through and resulting letter-flat weight differential were to be increased above the level proposed by USPS, as Val-Pak argues, then the pound rate must be reduced correspondingly." Correct?

A Yes, sir.

Q Okay. When you refer here to the level proposed by the USPS, you're referring to the zero pass-through at the basic level.

A No. I'm talking about just in general, letter-flat differences, just in general, and mostly with respect to high density and saturation, which is really where I focus, the high-density saturation level, the letter-flat difference there.

Let me put it differently. I'm taking as accepted what the Postal Service proposes for the basic rate letter and flat, the rate differential/cost differential, because there is something going on there that I'm not completely informed on. There is policy involved, there's other things involved, and

I'm not truly addressing that; I'm leaving that as is.

Q I'm just trying to get to the meaning of what your sentence --

A So what I'm really talking about is the letter-flat differential at the high-density saturation level.

Q Okay. But you say, if the pass-through and resulting letter-flat differential were to be increased above what the Postal Service wants, then the pound rate must be reduced. So you're saying you can't apply that to the basic level; you can only apply that to the high-density and saturation levels, your statement. What pass-through is the Postal Service proposing for saturation, letter-flat?

A I would have to look it up. In fact, I don't even have it, to tell you the truth. I don't have what they are proposing. I haven't got that in my notes.

If you increase that pass-through, and you leave the pound rate alone, you're effectively deriving more revenue from flats than before.

Q So you have to change the pound rate, you're saying, at that point.

A Right. If you're deriving more revenues than before, and the costs are the same, then

obviously what you're doing is marking up flats even more than it's already marked up, and it's on that basis that I say this.

Q Your statement doesn't have any application to pieces that don't pay the pound rate, I take it, the minimum per piece.

A Yes, it does because the letter-flat rate differential applies to piece-rated letters and piece-rated flats. It's the rate differential between piece-rated letters and piece-rated flats. As you pointed out, it's also the rate differential for the piece part of the charge for pound-rated mail.

Q Let me go at it the other way. If you were to decide to decrease the pound rate, does that mean the Commission should increase the letter-flat cost differential?

A Making all the changes?

Q Yes.

A No, because the truth of the matter is flats are paying too much now. You know, --

Q So it's a one-way street.

A It's not a one-way street, in that sense. I assume we're talking about this case, this set of rates, and I think we've demonstrated that high-density saturation flats, even with their higher unit

cost, are making a larger percentage contribution. So if what you're trying to do is equalize percentage contributions, which is one of the points I thought Mr. Mitchell was trying to get at, then you don't do that by taking on one hand and giving back at the other. I mean, you don't do that.

Q What I'm trying to get at is more the relationship between the pound rate and the minimum-per-piece rate. If you keep the same coverage on the subclass, you've decreased the pound rate, what will the effect of that be on the minimum-per-piece rate?

A It could increase it as long as you're not double recovering. The question then becomes how much are you decreasing one and increasing the other? You can't just decrease one a little bit and increase the other a lot, so you need to balance it and make it even.

Q A fairly complex rate structure.

A It is. It's very complex.

Q Would you look at the top of page 3, line 1? I'll just read the sentence. "The true comparison of product cost coverages requires a comparison of total nonwork-share-adjusted costs and total revenues. Mr. Mitchell's comparison, by contrast, looks at a work-share-adjusted, letter-flat cost differential." When

you say "work-share-adjusted cost differential," would you agree you're talking about drop-ship adjusted only?

A Yes, sir.

Q Can you point to a place in Mr. Mitchell's testimony where he develops or shows any cost coverages for any products within ECR?

A He doesn't.

Q Could you take a look at the table on page 3 in the middle there? The way that you develop product costs, it looks like you're viewing saturation letters as one subclass and saturation flats as another subclass. Would that be correct?

A Yes. That's how I've done it.

Q And you agree that separate subclasses for saturation letters and flats don't now exist. Correct?

A Now they are all part of the ECR subclass.

Q They are not being recommended by Val-Pak or its Witness Haldi --

A As far as what Mr. Mitchell is proposing, he uses the term "product," so that's the term that I used, is product. Whether that means subclass or not, from his point of view, I can't tell you.

Q You can't identify a proposal by Witnesses

Haldi or Mitchell to create separate subclasses for saturation letters and saturation flats?

A I'm talking about separate products.

Q Do you think there is a proposal on the floor before the Commission to create separate subclasses, to actually create separate subclasses?

A No. I think what I'm dealing with is the proposal to charge letters and flats as separate products.

Q So you know there is no proposal to have separate subclasses. "Separate subclasses" has a certain meaning at the Commission. Correct? If there are to be separate subclasses, they have separate markups, for example.

A Yes, sir. I know that.

Q Okay. Would you look at the top of page 4, beginning on line 1? Let me see if I can shorten this a bit. You say, "There is no need to pass through any more of the high-density saturation letter-flat cost differential than already proposed by the USPS. However, if the Commission chooses to increase the letter-flat rate differential, it should concomitantly reduce the ECR pound rate." Correct?

A Yes, sir.

Q When you discuss the letter-flat pass-

through at the beginning of your testimony on page 1, you do it at the basic level. Correct? We've looked at those before.

A I'll have to get it again.

Q Sure.

A On page 1, all I'm doing is explaining what I think Mr. Mitchell has recommended or what he is saying. So on page 1, I'm just explaining what I think he is saying.

Q Regarding his testimony about the basic level?

A Yes, sir.

Q Okay. And here, you talk about the high-density saturation level. Correct?

A Yes.

Q Are you aware of the fact that the Commission's work papers, in the last 15 years of cases, always showed the letter-flat differential being set at the basic level and not at the high-density or saturation level?

A Excuse me?

Q When a letter-flat differential is set, that it's set at the basic level, and then there are adjustments made to get from the basic level down to high-density and saturation level, but basically there

is a recommendation with respect to the basic level for the letter-flat differential.

A I wouldn't have said it quite like that. Commission work papers always -- I've looked at the past couple of them just recently -- they always show the cost difference and the pass-throughs at all of the density levels. They always show that. Now, there is effectively on the rate schedule -- and actually even on the rate schedule it's not shown. Those rate differentials are the differences between the rates for letters at each density level and the rate for flats at each density level. So I'm not sure exactly what you're talking about.

Q Let me repeat it. You can calculate letter-flat differentials for other products like high density and saturation, but it is set at the basic level. Is that not your understanding? If it isn't, that's okay. I just wonder what your understanding is about the way it's been done in the past.

MR. McLAUGHLIN: Mr. Chairman, I may want to clarify this. By being set at the basic level, do you mean that is the way that the spreadsheet accepts inputs into the formulas, or are you referring to the process by which the Commission judgmentally arrives at the final set of reasonable rates?

MR. OLSON: Probably the former.

MR. McLAUGHLIN: So you're talking about the way entries are made in the spreadsheet.

MR. OLSON: I think it's a little more than that, but if that's helpful to Ms. Crowder.

THE WITNESS: I'm not sure I understand what you're saying. I don't see that they just set -- when they do the algorithm, several of the differentials are in there. I just don't understand what she is getting at, so I can't confirm it.

BY MR. OLSON:

Q Could you take a look at page 22 of your testimony? Starting at line 10, you discuss the "problem," in quotes, --

A Yes, sir.

Q -- and you say, "The IOCS in-office casing cost for ECR saturation flats used in Mr. Kelley's step one includes the cost for casing DALs as well as flats."

A Yes, sir.

Q Let me ask you if you understand what it means to collate two bundles of flats. Do you understand that concept?

A Yes, I do.

Q If a carrier is subject to an IOCS tally

while collating two bundles of saturation flats, do you know if the tally would be recorded as the carrier casing saturation flats or something else like specifically saying collating?

A I honestly don't know. I can't answer that. But this particular sentence, I was talking about really just the in-office costs in total would include that. The in-office costs in total would, of course, include collating.

Q Are you familiar with the way that Witness Bradley develops his estimate about sequence mail casing?

A Yes, sir.

Q If the IOCS records collating as casing, that would have an effect on his rough estimate of the number of flats that are cased. Correct?

A Yes, it would.

Q Other than the approach which Bradley used, do you know if there's any other data on which they could have relied to make a more accurate estimate of the number of flats which were cased and the number, therefore, which were taken to the street directly?

A No, I don't.

Q If the new carrier cost study is going to have a separate pool for sequenced mail, would you

recommend that they get better data as to how flats are being handled in the office?

A Yes, I would, very much so.

Q We can agree on that.

A Yes, sir.

Q At the top of page 23 of your testimony, -- I'm on line 7 -- it says: "And because sequenced delivery unit cost is less than regular delivery unit cost, a correction of the total delivery cost for saturation flats and for ECR in total would make it lower," and you go on from there. Correct?

A Yes, sir.

Q I want to explore that statement with you and start by taking the delivery cost and breaking it down into components and asking some separate questions, starting with in-office cost. If you have sequenced mail, using Bradley's terminology -- you're familiar with --

A Yes, sir.

Q -- what he calls "sequenced mail," the mail that goes directly to the streets, and not all sequenced mail because sequenced mail which is cased or DPS'd like Val-Pak's pieces might be, she doesn't call sequenced mail, even though they are sequenced. Correct?

A That's correct.

Q The in-office-cost sequenced mail that carriers take directly to the street, have almost zero in-office cost. Is that not correct?

A There is some in-office cost, but it's not nearly as much as the in-office cost for mail that has to be cased. I wouldn't say it's nearly zero; it's pretty low, though.

Q What would it reflect, just moving volume out to where the carrier could take it to the street?

A It could reflect -- to be truthful, I'm not real certain exactly what each of the categories includes, but, in total, the in-office cost would reflect things like if the carrier has to go and pick up the mail from somewhere, and he has got in his hand, or if he is handling it as a bundle or if he is handling it so that he is doing some kind of collating, or he is just looking at it, or he is taking it out to his truck and manipulating everything at the truck or where he is taking his relay bundles. If he is the foot carrier, then he may take it somewhere to prep it so that somebody else can carry it out to his relays. Then in-office cost has some other stuff that's a burden -- that reflects out-of-office activities.

Q But whatever, it's got to be small.

A Yes. I agree, but I wouldn't say it's nearly zero.

Q Okay.

A It's a small amount, yes.

Q And if a piece of saturation mail is taken directly to the street, whether it be a letter or a flat, it has a lower in-office cost than if the mail is cased, for example. Correct?

A Yes, sir.

Q Okay. And if a saturation letter is taken directly to the street as a third bundle, it has a lower in-office cost than being DPS'd, if it were to be DPS'd. Correct?

A Well, I haven't looked at the specific DPS cost, but generally that's correct, yes.

Q You can't conceive really of running these saturation letters over DPS equipment and have a lower in-office cost than taking it directly to the street, can you?

A No, not right now. I just don't know.

Q Would you agree that walk-sequencing mail, letter or flats, adds value for the Postal Service, to the extent that it allows the Postal Service to reduce their costs when it bypasses casing and DPS'ing and

goes directly to the street? Does it add value in that situation?

A It adds value any time the carrier can use the sequencing and doesn't have to do it himself, yes.

Q My question was about taking it directly to the street, that the mailers work in walk sequence and that mailing of saturation mail, that adds value, so the Postal Service can save costs when the pieces are taken directly to the street. Would you agree?

A Walk sequencing adds value in the event where the city carrier has to case, and it adds value at that point because it's much easier for him to case, --

Q In addition.

A and in addition, if it's already walk sequenced, and he is able to take it out as a sequenced extra bundle piece or mail, then there is value there as well.

Q In both situations.

A Yes, sir.

Q Now it obviously has greater value when it's taken directly to the street, does it not, than when it's cased?

A Has greater value to the postal service. Yes.

Q In fact, when you have a carrier case mail that's already been walk sequenced you're destroying the value of the presortation to some degree except for the fact that you can do it a little quicker perhaps. Is that not a reasonable statement?

A Maybe you should repeat that for me.

Q Would you agree that when a carrier cases sequenced mail that he or she is actually destroying the value of walk sequencing? Now, I understand what you said. You can do it a little quicker when you're casing a walk sequence mailing, but aren't you destroying some of the value? You said there was greater value if it goes directly to the streets than if it's cased I believe, correct?

A Well, if the carrier can take it out on the street as a sequenced extra bundle mail I suspect he would do that --

Q It would have the greatest value then?

A -- and if it didn't make sense for him to do that then there is -- no, he's not destroying any value because he wouldn't have done that. What I mean is if he can't take it as a sequenced mail extra bundle mailing, which is what he would do if he could, if he can't do that then there wasn't any value to it from that perspective.

The only value then becomes the value of casing that mail more quickly because the mailing is in walk sequenced order.

Q So your position is that whenever a mailer can take a sequenced mail to the street he or she is now taking it to the street. That's what you just said?

A My understanding is if a city carrier has a sequenced mailing on a particular day and he can take it out to the street as an extra bundle and you know if it's the kind of thing that makes sense to take out onto the street as an extra bundle or sequenced mailing he's going to do it because it saves him time.

Q Whether it's a letter or flat?

A Yeah. He's going to do it. Of course he's going to do it.

Q If a decision is made by the postal service however to take let's say saturation letters and DPS walk sequence saturation letters and let's assume it's in a situation where they did not have to, that they could have taken them to the streets, they had excess capacity to the street but didn't do it, would that be destroying the value of the walk sequencing of those saturation letters?

A In that case there would be no value to the

walk sequence. It would be no value because they actually take it apart and then put it back together again in the two pass system.

Q Do you have a problem with calling that destroying the value that the mailer put into the mail?

A Well, the value -- you're talking about value from the perspective of the postal service.

Q Yes.

A So I would think the postal service would do what was most valuable to the postal service.

Q No. I'm postulating.

A So if the postal service is deciding that it's more valuable to DPS the saturation letters with other letters that it's DPSing and they're placing a higher value on that than on treating the letters any other way that's their decision and I think they ought to know what's most valuable to them in terms of processing those letters.

Q So you're assuming the postal service will make the most efficient selection of delivery processes?

A You have to assume that. Yeah.

Q Take that on face?

A As an analyst I have to. That's the only

way I can do it. Yes. I have to assume that.

Q If there were a policy at the postal service to maximize the number of letters that are DPSed and a decision was made to DPS saturation letters even when those letters could be taken to the street as the third bundle would that be at odds with your assumption about the postal service choosing the most efficient method of delivery?

A No. Not necessarily. To tell you the truth I really don't know what goes into their decisions on that. All I see is the result of their decision and I have to assume that they are making the best decision for their total system, and for all their costs, and for all their volumes and I don't have any other basis to go on.

Q Do you recall some years ago when the postal service handled mail on letter sorting machines and had multi-position letter sorting machines and there were stories about the postal service running mail over those machines that didn't need that to improve ROI? Does that ring a bell? Tell us about that?

A No. I don't recall anything about -- those multi-position letter machines, I don't recall that.

Q If the postal service had no reason having to do with efficiency to take the saturation letters

and run them over DPS equipment, in other words, if there was adequate capacity and they could have taken them to the street as third bundles to be distributed would you characterize their decision to require that they DPS those letters as inefficient and uneconomical?

A Okay. You're really starting to get into my opinion of what the postal service decisions are and I can't give you that because I don't know how they make their decisions, but here's what I do know. Letters are more difficult to carry out as extra bundles for delivery point where the carrier has to walk between delivery points.

I forget what portion delivery points is, but letters are awkward to carry out as extra bundles like, you know, they do flats. Now, you can take letters out as extra trays on other kinds of delivery points and I know that they do that sometimes. The problem becomes that a route isn't all one thing or the other.

Most routes have multiple kinds of delivery points, multiple kinds of delivery point sections, and most saturation letter mail arrives at the SCF --

Q Well, we're going to get to this in a second.

A -- and the SCF doesn't know, so what are they going to do?

Q The SCF doesn't know what?

A They don't know what portion of the route could be taken out as extra bundles or extra trays or which routes. They don't know that. To be able to have to break up a letter mailing in order to do that sounds to me like it might be pretty time consuming.

Q Well, we're going to get to the basis of that assumption in a second because you have something in your testimony about that, but I just want to finish this illustration on street time unit costs. At page 23 of your testimony you imply that the out-of-office street time delivery cost for sequenced mail is lower than for the delivery of cased or DPSed mail, correct?

A That's correct.

Q How does the out-of-office unit cost for sequenced flats compare to the out-of-office unit cost for regular cased flats?

A It's lower.

Q Do you know by how much?

A I'm sorry. I don't remember now. It's considerably lower.

Q Where would you look to find that out?

A I think you would probably look in some of the materials that Dr. Bradley has.

Q So you're talking about the new Bradley city carrier cost study?

A Yes, sir.

Q Okay. Let me ask you, you said you couldn't speak about letters, but I'll ask you about flats. Let's assume that the postal service were to develop, to perfect, to deploy a flat sorting machine and that could sort addressed flats into delivery sequence the way that letters already can be DPSed, okay? Do you have that assumption in mind?

A Yes, sir.

Q Could you then assume that the postal service as a policy decides to sequence all addressed saturation flats, okay?

A (Nonverbal response.)

Q Now, from what we discussed before the saturation addressed flats then incur mail processing costs for running through that machine and higher out-of-office delivery costs for cased mail or nonsequenced mail that you discuss in your testimony, correct? That would be the affect?

A I don't know how it would look then to tell you the truth. You're talking about a different set

of operations entirely and I would hope that this would be a decision the postal service would make that would reduce everybody's costs.

Q Would you agree that if the postal service decided to automate the sorting of addressed saturation flats that it would destroy the value that mailers put into it by sequencing those flats?

A To the extent that they were processing flats for *X* number of routes my understanding is that even the DPS letter program isn't applicable to all routes. In other words, there are routes in delivery units where they do not receive DPS mail and in those cases there's quite a bit of value. Of course that's true also for letters, which I forgot to mention before.

Q If those flats had enough density to go to the street directly would automated sequencing of those flats likely minimize the total cost to the postal service in handling those flats?

A I would hope so if that's what they decide to do.

Q Do you have any reason to believe that running it over such a machine would minimize the costs of handling those flats rather than taking them to the street as a third bundle?

A You know, this hasn't happened that often, but when the postal service starts making changes operationally there are a lot of things that get changed and I really don't want to speculate on all the procedures and processes that might change. We just don't know how it would look.

If you're saying nothing else would change then maybe the unit cost for those saturation flats might go up, but that assumption of no other things change is not a realistic assumption.

Q Let's go back to the saturation letters and your view of the out-of-office costs for those saturation letters that are taken directly to the street. Can you compare that to the out-of-office unit cost for letters that are DPSed or cased? Do you think it's the same? Do you think one is more or less than the other?

A No. I haven't looked at that.

Q Let's think about the regular delivery cost pool for cased slats. Do you know if that pool includes all flats except saturation flats?

A No. That pool -- maybe you better repeat that. You're talking about the cost pool itself?

Q Yes.

A The cost pool includes the cost for all

flats that are delivered by regular delivery.

Q It's not all flats that have to be cased?

A All flats --

Q Saturation flats that are taken directly to the street which are considered sequenced mail?

A Let me phrase it my way.

Q Sure.

A There is a regular flat delivery cost pool and that is for flats that are not taken out as extra bundles; therefore, those flats have to be cased. Then there is a cost pool for all letters and flats, all volume that is carried out as extra bundles. Not all saturation flats are considered to be represented in the extra bundle sequence flat pool.

Q That's what I thought I was getting at. Yes. The regular delivery cost pool, not the sequenced mail, but it's for flats that are not taken directly to the street so obviously they're cased, correct?

A Correct.

Q Do you know the approximate volume of saturation flats?

A I think it's a little less than 10 billion, saturation flats.

Q I've got --

A That's an RPW number.

Q -- 10.3 billion in my notes --

A Okay. A little more than 10.

Q -- so you're right on the money. The volume of standard flats that are nonsaturation flats, in other words, all commercial, nonprofit, regular ECR --

A I have no idea.

Q Well, we get a number about 28.6 billion. Do you want to jot those two down? 10.3 saturation flats, 28.6 nonsaturation flats. When carriers are delivering sequenced flats, on average how many pieces do you think they deliver to each address?

A On one day?

Q Yes.

A Probably one.

Q Probably one or sometimes two?

A Yeah.

Q So on average --

A Let me make sure I understood the question. You asked how many sequenced pieces they might deliver on a day?

Q Yes. Sequenced flats.

A All right. When they have it it's probably one or less than that.

Q Well, I'm talking about the days where they

actually have a sequenced flat, if we think about it that way.

A Yes.

Q So they have to have at least one. They're either going to have one or sometimes maybe two and so on average wouldn't you say it's just a little bit more than one?

A No. No. Actually, I wouldn't because I do know that sometimes the carriers will split a mailing and they'll take part of it out one day and part of it out the next.

Q Well, I don't know that affects what I'm talking about. I'm talking about when you have a --

A You're saying per delivery?

Q Yes.

A For any delivery that gets a sequenced mailing it's one or more.

Q Or a little bit more.

A Right. Correct.

Q Okay. That's what I'm getting at. When carriers are delivering regular cased flats, that is they have at least one regular cased flat to deliver to an address, do you have any idea the average number of cased flats they would be delivering to each address?

A No, sir.

Q Well, since the volume of cased flats is about three times the volume of all saturation flats would you think the average number of cased flats would be somewhat larger than the number over one that we had for saturation flats?

A On those days where that delivery point gets a sequence.

Q Nonsequence in this case. We're talking about non -- I'm sorry. Cased, not third bundle flat.

A Okay, but I'm asking you first of all on days where that delivery point gets a sequenced mailing it gets one or more --

Q One or a little more.

A On those days. Now, are you asking for those same days how much other flat mail it might get?

Q No. I'm thinking about the other flats differently. I'm asking you about those --

A On average how many pieces per day, per delivery point?

Q Yes.

A I can't answer that.

Q Since the total volume of cased flats is three times the total volume of all saturation flats it would be higher would it not?

A On average, yes.

Q When on a particular day a carrier has no sequenced flats for delivery obviously his cost on that day is zero. I mean, that's obvious, right?

A His sequenced flat cost is zero.

Q Sequenced flat cost. If he has no cased flats on a given day his cost of handling cased flats is zero on that day?

A Yes.

Q So if we're trying to do an apples to apples comparison we want to compare the unit cost of delivering sequenced flats when there's at least one sequenced flat to deliver versus the unit cost of delivery cased flats when there's at least one cased flat to deliver. Would that make sense?

A I don't believe that -- it may make sense to what you're trying to do, but when these unit costs are developed for cased and sequenced mail from Dr. Bradley's model his model doesn't estimate the cost as if one piece of sequenced mail is going to a delivery point one day and *X* number -- his model looks at the whole system and what's going on in the system based on the diversity of types of pieces by different kinds or delivery points.

I mean, it can't be that simple. Obviously,

if all you're doing is delivering one piece to a delivery point the cost of that piece is going to be more expensive than if you're delivering that one piece plus 20 others because there's scale economies involved.

Q Well, that's exactly what I'm getting at. The statement in your testimony that compares out-of-office unit costs of sequenced mail and cased mail doesn't make the comparison we're talking about, does it, of for those days when you have a sequenced mail, for those days when you have a cased flat?

A You'll have to point it out to me again. What statement have I made?

Q It might take longer than we have for me to find that right now, but let me --

CHAIRMAN OMAS: Mr. Olson?

MR. OLSON: Yes?

CHAIRMAN OMAS: Excuse me. Since you're looking and you can't find where you need to be why don't we take this opportunity to break for lunch? How much longer do you need with this witness?

MR. OLSON: Perhaps 20 or 30 minutes.

CHAIRMAN OMAS: All right. I think we'd best go ahead and go to lunch and come back at 1:30.

MR. MCLAUGHLIN: Mr. Chairman, before we

break, Mr. Otuteye will be here by 1:30 and prepared to testify and he would like to catch a plane tonight back to California if he could. I know that the Commission doesn't like breaking in on a witness. We would prefer if at all possible to have him take the stand promptly at 1:30 so we can try to get him out of town today.

CHAIRMAN OMAS: Well, I don't know. We'll talk about that. Thank you.

(Whereupon, at 12:25 p.m., the hearing in the above-entitled matter was recessed, to reconvene at 1:30 p.m. this same day, Wednesday, September 14, 2005.)

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A F T E R N O O N S E S S I O N

(1:38 p.m.)

CHAIRMAN OMAS: Again, I apologize for not having a buzzer. I hate to sound like a school teacher. Will everybody please take their seats?

Mr. Olson, you may continue.

MR. OLSON: Thank you, Mr. Chairman.

FURTHER CROSS-EXAMINATION

BY MR. OLSON:

Q I'll repeat that I've found the page references that I was searching for before the break and in your testimony the first is to page 23, lines 7 and 8. There you say and because sequenced delivery unit cost is less than regular delivery unit cost a correction of the total delivery cost for saturation flats and for ECR and total would make it lower.

When you say *delivery unit cost* are you talking about street time there?

A It could be street time but actually I was considering total time -- total delivery time.

Q Well, then take a look on page 31, footnote 19. In the last three lines there you say extra bundle volume avoids in-office carrier costing and the out-of-office delivery cost for such mail is also lower than for delivery of cased DPSed mail. So your

position is that the out-of-office delivery cost of sequenced mail is lower than the delivery of cased or DPSed mail, correct?

A Correct.

Q What I'm trying to get at is how the numbers are developed because you're working with information that witness Kelly came up, correct?

A Yes, sir.

Q Then I guess Dr. Bradley used it. Witness Kelly had it, was it in Library Reference 67?

A Kelly does 67. I think he characterized them just a little bit differently. Kelly takes Bradley's cost pool and distributes them, so Kelly is working off of Bradley and not the reverse.

Q In this case we're talking about the unit costs of handling sequenced flats versus cased flats. I'm trying to figure out the way you'll understand what Kelly did is that he took addresses which got at least one sequenced flat on a given day and figured the unit cost, and he took addresses that got at least one cased flat on a given day and figured out the unit cost and compared the two.

That would be apples to apples as we were talking about before. Do you recall that?

A Kelly didn't do that at all. On the out-of-

office costs you can directly get from Dr. Bradley's models the marginal unit cost for those various kinds of mail, the sequenced mail, the regular flat, the regular letter and then some other things as well. So right off of Bradley's model you can get that.

That's the basis of what I'm explaining here. Also, his model gives you volume variability percentages and those percentages are applied to the regular delivery cost pool in this particular case that Mr. Stevens developed, and then with those two sets of information you can get cost pools for regular delivery and for sequenced delivery.

Then there's separately you get the CCS figures.

Q Let me just stick with those two. Do you know that when they developed unit costs if they divided by all flats or took the delivery costs of sequenced flats and divided by sequenced flats that got at least one delivery on a given day and the same thing with flats that were cased?

In other words, I'm trying to figure out what the denominator is. Did they divide by the relevant denominators so we can make a proper apples to apples comparison?

A All right. The unit numbers that I gave you

or that I'm quoting to you based on this, those unit numbers you can get directly off of Dr. Bradley's model. I do not have to go through Mr. Kelly's spreadsheet to know that. Those are direct units, but they're a unit cost, a marginal cost given the entire system of city carrier routes as it appears for the period that the data were collected.

All that Kelly really does is distribute the cost pool developed from Bradley's volume variability and Stevens' accrued cost pool and distributes that.

Q Whenever you develop a unit cost you have to divide by volume, correct?

A Yes.

Q When you develop costs that you want to compare to each other you have to make sure you're dividing by the right volumes?

A Yes.

Q All I'm asking is if you know if the way those costs were developed that you're relying on for your conclusion had the right volumes in the denominator that pertain to the costs in the numerator?

A For the sequenced cost pool?

Q Yes. For that and then for the cased flat cost pool.

A Okay. What we're talking about here then -- what I'm discussing in that one sentence that you've just quoted is the fact that the distribution keys for those cost pools, which is what I think you're probably getting at, are not as precise as they ought to be and that's what Dr. Haldi was talking about.

That from the CCS volume data we had to -- we had to, I mean the postal service had to estimate what proportion of CCS flats and CCS letters were sequenced. Mr. Kelly made that estimate and then so a certain portion of CCS flats he considered sequenced and the other portion were considered regular delivery, but Dr. Haldi pointed out that --

Q This is a different issue.

A No. That's exactly what he pointed out, but that they probably weren't right.

Q I agree, but once you have figured out the numbers, whether they're right or wrong, of the volume of sequenced flats and cased flats taken directly to the street did they use the numbers that related to the costs? Do you know? The volumes that corresponded to the costs.

A Okay. This is what they did. They used those volumes to distribute costs of the relevant cost pools among the subclasses, and that was witness

Meehan. Karen Meehan did that, okay? So the CCS volumes that were estimated as regular delivery flats, regular delivery letters and sequenced flats, sequenced letters, those were used by Karen Meehan to distribute the cost pools to the various subclasses.

So we had the cost pool for ECR, we had the CCS volumes that were estimated to be regular delivery and sequenced delivery and all Mr. Kelly did was make the relevant distributions among categories of, you know, density categories and shape.

Q So you're saying you believe he used the right volumes for the right costs?

A I think that the intent of doing what he did was appropriate and it was right. I am to some extent agreeing with Dr. Haldi that he probably underestimated saturation sequenced flats and therefore overestimated saturation cased flats.

Q Now, let me tell you why I'm asking and maybe this will help you see the point. We talked before about how there were about 10 billion sequenced flats out there that were --

A 10 billion saturation flats.

Q Yes. I was going to go get the number. Yes. 10.3 billion of saturation flats, thank you, and 28.6 billion of standard flats that were not

saturation flats, correct?

A That's what you've given me. Yes.

Q I'm just asking you to assume that. When we talked about sequenced flats we discussed how chances were they would have one on a given day for those addresses that were given a sequenced flat and maybe a little bit more because some days they might have two, so the average might be 1.1 or 1.2 for sequenced flats. Remember that discussion?

A Yes, sir.

Q Okay. Then we talked about the nonsequenced flats where they have 28 billion of these. If you're going to go to a door and delivery a nonsaturation flat chances are your number of deliveries per address is going to be significantly higher, correct?

A Yes, sir.

Q So this causes me to ask you if you think that the Bradley/Kelly/Meehan numbers which postulate a lower unit cost for saturation flat delivery are counterintuitive in the sense that remember before you said if you're going to go to a door and you're going to flip through a couple of these things and deliver them you'd assume there are some economies of scale. Do you recall that?

A Yes, sir.

Q So are these results that we have from the postal service that you're relying on counterintuitive to you?

A No. Not in the least --

Q Tell me why.

A -- and I do not agree that if there is a sequenced piece going to a delivery that's the only piece that goes to that delivery. That's what I was trying to explain to you. You cannot assume that is the only piece that goes to that particular delivery. It goes with whatever else goes to that delivery.

Since different deliveries get different amounts of volume and different deliveries have different characteristics all of that information is recognized in the Bradley results, and that's all I was trying to explain.

Q If a carrier is flipping through flats and he or she has three of the nonsaturation flats for a particular address then you develop a unit cost of those flats, and you're suggesting that the unit cost of delivering three is higher than the unit cost of delivering one. I'm asking you is there -- we're not talking about all other mail, we're talking about flats.

Does that not reflect a diseconomy scale?

Is that not an anomalous result?

A No. You're not characterizing it correctly. That's just not the way it works. All the mail goes to the delivery. It may be one or two pieces of sequenced maybe and a couple of flats, a couple of letters. All of it goes. Bradley's model recognizes what the costs are for that particular delivery along with all the other deliveries in the system.

Each delivery might be slightly different, but from the marginal cost basis his model captures all of that and that's what we've got. So you can't look at it just as one delivery and well, he's delivering one piece here and then three pieces there. It's just not that way.

Q If I can help state what I think you just said and see if this is accurate are you saying that because a carrier is delivering letters, flats, parcels conceivably, that you cannot compare the unit costs of handling saturation flats versus nonsaturation flats, you have to go to the model? You can't simply look at the unit cost of delivering those flats?

A I think that's what the model gives you. Maybe you ought to try it a different way because I just --

Q No. That's all right. I'm grateful for what you're helping on. It gives me some direction. Let me ask you to turn to page 32 of your testimony, lines 1 and 2. I know this picks up in the middle of a sentence. Well, the word on the last page is *further*.

Further, he (meaning Haldi) theorizes that saturation letters are generally not taken out as extra bundle mail because the USPS reserves that capacity for saturation flats. Do you see that?

A Yes, sir.

Q The operative word is *theorizes*.

A Okay.

Q You're saying you don't know a basis for such an assumption, correct?

A I know that he heard something from Mr. Lewis on it, but I think that was probably just a take off from something. Yes. I think he theorizes that's exactly what's going on.

Q The implication I'm getting from you is that you think he misunderstood what witness Lewis said?

A I don't think that witness Lewis was able to explain himself completely. I happened to be there at the time that he spoke and it was a very brief response and with very little follow-up, and I think

that probably it should have been explored a little bit more.

Q Well, I was doing it and I'm the one responsible for however short or long it was. Let me just have a couple of this -- witness Crowder, this is the transcript that I think we're discussing. It's Volume 6, pages 2435 to 2437. I'm going to pause and allow you to review that and then direct --

A Yeah. You want me to read the whole thing?

Q Well, I think it might be helpful. The part that I'll eventually get you to is page 2436 at lines 16 to 22, but it's discussed before that as well. Okay. You've gone through it?

A I think so.

Q Thank you. Let's go to 2436 and this is a little bit before and a little bit after the oral cross of witness Lewis that I believe we're both referring to. Is this what you are referring to when you think --

A I assumed that's where he was taking off from. Yes.

Q Let me just start at line 5 and read this. This is witness Lewis testifying saying sending it straight to the street has some inconvenience and contingency things associated with it as well that

would lead me to say send it back to the plants and put it into DPS. Obviously, he's talking about letters because he's talking about DPSing them, correct?

A Yes, sir.

Q He says to me, understand that? I ask I think some of the contingency factors are that there could be for example another saturation flat mailing. He says correct. I said that you would want to take to the street more than you would want to take an ECR saturation letter mailing to the street, correct? He says correct.

Then he explains today I am looking at my mail for tomorrow, but tomorrow the plant might find something that's committed for tomorrow that should have been there at the same time. I always prefer to leave myself some contingency. That's why I would send it back. That's what I have in thinking it through this answer. That's the way the transcript reads.

Do you have any reason to doubt based on refreshing your recollection about that exchange that witness Lewis was saying that he would perhaps DPS a letter mailing today because tomorrow the plant might give him a saturation flat mailing that he would want

to bring out directly to the street?

A Just a minute. Let me get it. I have a postal service response. It's ADVO/USPS-2. I don't know how to do this. Do you happen to have that?

Q Yes, I do.

A There is a copy of a postal service letter to managers of the delivery program support and managers of in plant support. It says that for those zones being processed to DPS all automation compatible letter mail is to be processed to the DPS level including carrier presort within operation parameters.

Q Mr. Crowder, let me just say first we can do that, but my question is about the testimony to begin with because you --

A Well, this is my basis for what I have said.

Q Well, I asked you if this was what you were referring to. You said you were there in the hearing room.

A I am referring to Dr. Haldi's testimony when he says, and I'd have to go look for it, words to the effect that letters are pushed aside in favor of slats to do sequencing or to be carried out as extra bundle. I may not say it exactly right. I can find it precisely if you wish, but I am addressing what Dr. Haldi said.

Then you asked me something about it and I said I suspect Dr. Haldi made that comment on the basis of what witness Lewis said during cross-examination.

Q Well, it would be a reasonable assumption since the ADVO responses didn't come in until after Dr. Haldi's direct testimony was submitted and the date of his cross-examination, correct?

A Yes. I understand that.

Q Now, this is late filed discovery that the postal service chose to answer for ADVO and you have an answer and let's go over that in a second, but I want to focus for a second on what witness Lewis said on the stand under oath about the way that a manager would handle a saturation letter mailing and a saturation flat mailing.

Confining yourself for the purpose of the question, and you have counsel who will follow-up as he wants, will you tell me if you have any doubts that this says that they will from time to time protect this contingency, which he uses twice, that today they will choose to DPS a letter mailing to protect themselves so that if the next day they get in a saturation flat mailing they can take it directly to the street?

A I do not dispute what witness Lewis said. I do not dispute it.

Q Is it what Dr. Haldi's testimony was? A reasonable characterization of this statement by Mr. Lewis?

A I'd have to go back and look, but I think Dr. Haldi was talking about not just DPS letters, but all letters. Dr. Haldi also made the assumption that the postal service would take out letters, that letters were as easily taken out as an extra bundle of sequenced mailing as flats.

Q Let me refer to your testimony. You're characterizing Dr. Haldi's testimony. This is what you say, that Dr. Haldi theorizes that saturation letters are generally not taken out as extra bundle mail because the USPS reserves that capacity for saturation flats. I'll just ask this question.

Based on the response of witness Lewis to my oral cross was that a reasonable assumption as opposed to an abstract theory?

A That must have been because that's what he did. That is what he did I think. I can't say for sure, but that's what it sounds like Dr. Haldi did. That he based his claim on the little bit of transcript that you have on Mr. Lewis. I'm not

disputing Lewis.

I don't know exactly what he meant by all of that, but I have other information here that tells me that they DPSed letters because of the DPS program, not because they're trying --

Q Actually, I'm going to ask you some questions about that, but I do appreciate your clarifying this criticism of Dr. Haldi. Let me ask you to turn to page 32 of your testimony. At the very bottom you start a sentence and you're talking about curbline centralized cluster box and dismount deliveries that account for over 60 percent of all city delivery points.

Then you go to the next page, you say city carriers can take out multiple bundles, trays. This applies to both saturation letters and saturation flats. Correct?

A Yes, sir.

Q Then the very next bullet, or line, or whatever the subsection there is. For all deliveries city carriers, if they have too many saturation mailings to handle as an extra bundle on one day may defer some of those mailings to the next day or two. Correct?

A Yes.

Q That deferral option applies equally to saturation letters and to saturation flats, correct?

A Yes.

Q On lines 15 and 16 you say thus, city carriers have substantially more capacity to handle extra bundles than recognized by Dr. Haldi, correct?

A Yes.

Q Aren't you really saying that in your opinion city carriers have relatively few constraints in relatively few places to take saturation letters to the street?

A I prefer what you just read. I would say what you've just read which is that they have a lot more capacity to do this than what it sounds like from Dr. Haldi's description.

Q You think city carriers have significant excess capacity to handle extra bundles?

A No. I think I've said in other places that when they don't have they capacity that's already recognized in the costs that are in the cost systems. I'm not saying that it never happens, but it does happen and when it does it is recognized.

Q I'm trying to get to the capacity issue only, not cost systems, nothing else. All I'm asking about is capacity. I think what I'm getting from you

is that city carriers have thoroughly broad capacity to handle extra third bundles.

A They have capacity. Yes. There are techniques they use to allow them to handle as much mail as possible as a third bundle. That doesn't mean to say that all saturation flats are handled as third bundles or whatever, it just means that they have a lot more ways of doing it than it appears Dr. Haldi recognizes.

Q If that's the case would you not expect the postal service to be taking many saturation letters to the street as extra bundles?

A Again, I've explained that in this testimony. My understanding based on our discovery, and I will --

Q You're going to go back to the --

A Yeah. I just want to point out what I've got here. I don't have to read it, but it's the first several postal service responses to ADVO. I don't know if it ends at four or five, but that's the whole series of them. Based on things that I have heard in the past the postal service DPSes as much saturation mail as it can for that kind of saturation mail that either doesn't go to a DPSed zone or cannot be DPSed.

They can take saturation letters out as

extra trays. There is no problem with that. The only problem is when you have saturation letters going to delivery points like park --

Q Right. Right.

A Then it's awkward to carry saturation letters out as extra bundles.

Q We have a question on that, too, but let me ask you to then go to the next page to 34. There you say at the very top of the page with the exception of saturation DPS letters the USPS has consistently stated that city carriers attempt to take out all eligible saturation mail as extra bundles or trays.

You use the word *eligible* and then you drop a footnote and in the footnote you say by *eligible* I mean it would be more efficient to take that mail out as an extra bundle rather than casing it. Do you see that?

A Yes. I see it.

Q Now, when you say *eligible* are you meaning that it is -- let me ask you this. In your opinion are saturation letters eligible saturation mail?

A Yes. When they go to delivery points where you can take them out as extra trays.

Q What examples can you provide of instances where casing of saturation letters is more efficient

or less costly than taking them out as extra bundles where they can be taken out?

A This might be better directed to Mr. Lewis, but when a carrier has to take out an extra bundle of letters, and in fact this happened for a while in the mid-1990s, they were supposed to carry their DPS bundles in one set of fingers, and this extra bundle of letters in the other, and then their flats somewhere in here, and it was just extremely awkward and depending on what kind of letters they are trying to figure out what letter, you know, and you've got to look to see if the address is there and all this kind of stuff.

Q That's before VFC?

A That's when I think they were calling it a composite bundle. I can't remember the term right now, but yes, it was before vertical flat cases. They were trying to do that and it was very awkward. I believe that Mr. Lewis calls it -- I can't remember exactly how. He says it's ergonomically not practical.

Q Where does he say that?

A Or words of that nature. He uses the word ergonomics and I believe that's exactly what he's --

Q Do you recall where he said that? Is that

at oral cross or response to an ADVO interrogatory?

A Let me find it for you. Well, here is one place and this is on page 4 of his rebuttal testimony, lines 5 to 8. If one of the mailings is letter-shaped the manager is more likely to decide for both efficiency and ergonomic reasons to handle the letter-shaped mailing in the office.

I think he has some other places, too, where he explains. On page 3 he explains that the experience from earlier years working with I think he calls it composite bundle method that where carriers work from two letter-shaped bundles of mail was ergonomically difficult when carriers walked between delivery points.

Working from two letter-shaped bundles requires carriers either to use a finger to separate the two bundles or place the bundles back to back so the addresses are visible on either side of the bundle and then twist their wrist to read the addresses when fingering the mail.

Q Page 36 of your testimony, line 16, talks about saturation letters and you talk about saturation letters however are a different story. One major reason fewer saturation letters are carried out as third bundles compared to flats is that the USPS tries

to DPS all saturation letters delivered to DPS zones, et cetera, haul them back to the plant.

If you have a saturation letter mailing that has to be brought back to the plant doesn't that involve loading it onto a truck at the DDU for example first step?

A I would suspect so. Yes.

Q Would it involve unloading it at the plant?

A Yes.

Q Would it involve then making two passes on a DPS?

A Yes.

Q Would it involve reloading it back onto a truck back out to the DDU?

A Yes.

Q Then finally unloading it at the DDU?

A Yes.

MR. OLSON: That's all I have. Thank you.

Mr. Chairman, I'd like to ask that our cross-examination Exhibit Nos. 1 and 2 be transcribed in the record, not admitted into evidence, but just for clarity purposes they're the one with the numbers on unit letter flat costs and on the average weights from the billing determinants.

CHAIRMAN OMAS: Without objection.

(The documents referred to, identified as Exhibit Nos. 1 and 2 were transcribed into the record.)

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VP-XE-1 (Crowder) page one

ECR Saturation Letter and Flat Unit Costs
City Carrier Street Time & Rural Carrier Costs, Test Year 2006
per USPS Witness Kelley (USPS-T-16) & Advo Witness Crowder (Advo-RT-1)

Letter Unit Costs

with DAL Costs (Erroneously) Included in the Numerator of the ECR Saturation Letters Unit Costs
USPS erroneous letter costs -- 6.665 cents (USPS-T-16, Table 1, p. 6, rev'd 6/17/05) (p.12)
Crowder uses - 6.651 cents (Advo-LR-1; Print VersionLR-K-67_2d.revised.xls)

with DAL Costs (Correctly) Included in the Numerator of the ECR Saturation Flats Unit Costs
Kelley corrected letter costs -- 4.137 cents (*Id.*) (based on 3.375 billion DALs)

Crowder further corrected letter costs -- 3.629 cents (assuming 4.315 billion DALs) (p. 12)
Crowder demonstrates **decrease** in letter costs over USPS estimate -- 0.508 cents

Flat Unit Costs

with DAL Costs (Erroneously) Included in the Numerator of the ECR Saturation Letters Unit Costs
USPS erroneous flat costs -- 3.191 cents (USPS-T-16, Table 1, p. 6, rev'd 6/17/05)
Crowder uses - 3.197 cents (Advo-LR-1; Print VersionLR-K-67_2d.revised.xls)

with DAL Costs (Correctly) Included in the Numerator of the ECR Saturation Flats Unit Costs
Kelley corrected flat costs -- 4.163 cents (*Id.*) (based on 3.375 billion DALs)

Crowder further corrected flat costs -- 4.358 cents (based on 4.315 billion DALs) (p. 12)
Crowder demonstrates **increase** in flat costs over USPS estimate -- 0.195 cents

Letter/Flat Unit Cost Differential

	Erroneous Approach	Kelley Approach	Crowder Approach
DAL #	—	3.375 billion	4.315 billion
Flat Costs	3.191 cents	4.163 cents	4.358 cents
Letter Costs	6.665 cents	4.137 cents	3.629 cents
L/F Cost Diff	-3.022 cents	0.026 cents	0.729 cents

Note: DALs swing in ECR Saturation Letter/Flat Carrier Unit Cost Differential by 3.751 cents (3.022 + 0.729 cents)

VP-XE-1 (Crowder) page two

Costs (from page one).

Letter Unit Costs	Carriers Only
R2001-1 Approach	6.665 cents
Kelley June 17	4.137 cents
Crowder September 8	3.629 cents

Flats Unit Costs	
R2001-1 Approach	3.191 cents
Kelley June 17	4.163 cents
Crowder September 8	4.358 cents

How Much More Do Flats Cost Than Letters?

R2001-1 Approach	-3.022 cents
Kelley June 17	0.026 cents
Crowder September 8	0.729 cents

Standard Mail Enhanced Carrier Route Subclass
Basic Categories and Subclass Total
GFY 2004

MAIL CATEGORY	Revenue	Rev/pc	Pieces	lbs/pc	Pounds	oz./pc	oz/pc Incl NP, G4 p. 1
Total Basic Tier	**2,913,318,974**	**0.1885**	**15,456,246,242**	**0.1777**	**2,746,577,881**	**2.8432**	**2.73**
Total Basic Letters	**657,454,964**	**0.1620**	**4,059,336,122**	**0.0499**	**202,498,284**	**0.7982**	**0.80**
Basic Nonauto Letters	**370,356,707**	**0.1727**	**2,144,903,041**	**0.0598**	**128,272,895**	**0.9569**	**0.95**
No Destination Entry	67,376,327	0.1940	347,310,009	0.0384	13,324,519	0.6138	**0.65**
BMC Destination Entry	63,374,798	0.1730	366,328,298	0.0731	26,774,885	1.1694	**1.16**
SCF Destination Entry	216,742,540	0.1680	1,290,134,838	0.0653	84,200,169	1.0442	**1.03**
DDU Destination Entry	22,863,042	0.1620	141,129,896	0.0282	3,973,322	0.4505	**0.47**
Basic Auto Letters	**287,098,257**	**0.1500**	**1,914,433,081**	**0.0388**	**74,225,389**	**0.6203**	**0.63**
No Destination Entry	45,813,314	0.1710	267,914,032	0.0333	8,920,356	0.5327	**0.54**
BMC Destination Entry	83,788,107	0.1500	558,587,376	0.0433	24,194,980	0.6930	**0.70**
SCF Destination Entry	151,620,773	0.1450	1,045,660,165	0.0384	40,126,565	0.6140	**0.62**
DDU Destination Entry	5,876,063	0.1390	42,271,508	0.0233	983,488	0.3723	**0.41**
Total Basic Nonletters	**2,255,864,010**	**0.1979**	**11,396,910,120**	**0.2232**	**2,544,079,597**	**3.5716**	**3.43**
Basic Nonletters (piece-rated)	**950,333,596**	**0.1702**	**5,584,834,978**	**0.1233**	**688,444,205**	**1.9723**	**1.87**
No Destination Entry	62,539,731	0.1947	321,202,641	0.0913	29,330,192	1.4610	**1.43**
BMC Destination Entry	142,897,343	0.1730	825,995,384	0.1277	105,488,618	2.0434	**1.94**
SCF Destination Entry	727,690,278	0.1680	4,331,440,513	0.1255	543,586,092	2.0080	**1.91**
DDU Destination Entry	17,206,244	0.1620	106,196,440	0.0945	10,039,303	1.5126	**1.47**
Basic Nonletters (pound-rated)	**1,305,530,414**	**0.2246**	**5,812,075,142**	**0.3193**	**1,855,635,392**	**5.1084**	**5.10**
No Destination Entry	41,181,173	0.2747	149,916,791	0.3385	50,749,565	5.4163	**5.37**
BMC Destination Entry	148,940,003	0.2289	650,787,666	0.3154	205,264,736	5.0466	**5.03**
SCF Destination Entry	1,091,817,530	0.2223	4,912,110,086	0.3181	1,562,443,214	5.0893	**5.09**
DDU Destination Entry	23,591,708	0.2377	99,260,599	0.3745	37,177,877	5.9928	**5.96**
Total Enhanced Carrier Route	**5,108,780,906**	**0.1684**	**30,345,448,438**	**0.1700**	**5,157,341,977**	**2.7193**	**2.60**

Rounded

CHAIRMAN OMAS: Is there any follow-up cross-examination for witness Crowder?

MR. MCLAUGHLIN: We have no follow-up.

CHAIRMAN OMAS: Yes?

MR. WARDEN: Irving Warden from American Bankers Association.

CROSS-EXAMINATION

BY MR. WARDEN:

Q Ms. Crowder, in your discussions with Mr. Olson several things came up that did not deal with the ECR subclass that you're primarily testifying about including some discussion of some issues involving the extra ounce first-class letter mail. Is it correct that you did not in your response intend to give any expert testimony on that topic?

A Yeah. You're right. I don't know anything about first-class mail.

MR. WARDEN: Thank you.

CHAIRMAN OMAS: Are there any questions from the bench?

COMMISSIONER TISDALE: I have one.

CHAIRMAN OMAS: Commissioner Tisdale?

COMMISSIONER TISDALE: Ms. Crowder, in your revised version of Library Reference LRK-101 --

THE WITNESS: Yes, sir?

COMMISSIONER TISDALE: -- it doesn't seem to include any DAL adjustment for the rural carriers nor does it seem to eliminate the rural crosswalk problem. Is that correct?

THE WITNESS: Yes, sir. I would like to explain.

CHAIRMAN OMAS: Could you bring the mic closer, please?

THE WITNESS: When I did the PRC version in 101 in LR-101 I only calculated the PRC version of city costs and that's because the city costs are what is different between the PRC version and the postal service version. There should be no difference in how rural costs are handled between the PRC and the USPS.

The PRC total attributable cost for rural is the same as the USPS total attributable cost for rural, so the only difference was for city delivery cost.

So I used 101 to give the PRC version of city delivery cost, I adjusted that to reflect the number of detached labels that would be in load time for the PRC version of city cost and then to get a total PRC delivery number I took the rural cost from Library Reference 67.

Library Reference 67 is Mr. Kelly's version

of postal service cost and that had the correct rural crosswalk, so I took that. So what I did is I just took the city version of cost from LR-101 and the rural part of delivery cost from 67 and put them together. They are both adjusted for the detached labels and there is no rural crosswalk problem in the rural estimate from K-67.

So what I was trying to do was give you your version, the old version of city delivery cost adjusted for detached labels, plus the correct version of rural delivery cost adjusted for detached labels, and I combined those two in some of my spreadsheets and that is the figure that you get when you see my tables in my testimony.

The reason for that was it was very awkward to change all of 101, so I just did a very simple thing which is wiped out the rural part of 101 and used the rural part of 67.

COMMISSIONER TISDALE: Okay. Thank you.

CHAIRMAN OMAS: Commissioner Goldway?

COMMISSIONER GOLDWAY: It seems to me that in your testimony you feel confident with the cost figures as presented by USPS perhaps with some adjustment for PRC calculations.

My concern is that we've had tough time here

and in many, many cases before this about the reliability of the basic cost numbers, the carrier cost study, the mod data, and all of that is input into the cost that we see at the end here that we're debating.

Do you have any concern about the fundamental accuracy of these costs that we're debating, whether you feel we've in this particular exercise allocated them correctly?

THE WITNESS: Well, you're asking someone who makes a living at finding problems. I can always find something and I've noted a few things in my testimony, I didn't make adjustments for them and I've noted other things that I haven't made any comment about.

My thought about this is it's very easy to criticize and that's the kind of business I am in is to criticize, but when I criticize I try to find something that's significant, substantive, makes a big difference. There are always problems when you try to estimate costs. At such a large organization as the postal service you have so many products that are handled together.

I personally believe that the cost systems are pretty good. There's always room for improvement,

but I feel that they're pretty good and very, very -- I feel much, much better now that we have a new city delivery cost study. I realize that it's not perfect and I can find things about it, but it certainly is a heck of a lot better than what we had before.

So in general I think we're moving along, I think the systems are improving. There's room for improvement. What I find fault with is when someone says it always hurts us and not them, that the systems are biased. It always hurts this kind of mail and not that kind of mail. It doesn't work that way. When there are problems it can work either way.

On average you're hoping that you're getting a pretty good number. I have done cost work in other industries and I've been doing it for a long time and I find that the postal service, like I say it's not perfect, but it certainly is far more sophisticated and attempts to be far more accurate than anything I have ever seen before and I have done a lot of cost work.

So you're going to see me here in some other time and I'm going to be complaining about the cost, but it's not going to be little picky things and that, hopefully will be something that might be an improvement. Maybe I'm wrong, I don't know, but I

don't see that there's too much to worry about in terms of on average I think these are pretty reliable costs.

I very much like the new delivery cost setting.

COMMISSIONER GOLDWAY: I know you haven't prepared for this in your testimony, but we are facing a series of decisions that don't give us a full record of all the costs and data.

THE WITNESS: I understand.

COMMISSIONER GOLDWAY: Do you have a sense of maybe the top three areas for data that we might look at in the future to make sure that we do a better job?

THE WITNESS: Well, I think we've discussed two of them already and that is, and you have to understand I'm coming at it from the ECR saturation part of the industry, I like what I've heard about them being able to collect information on detached labels. I think that's real important. I don't want to have to be arguing about this all the time.

The second thing is on the delivery cost I think that they need to do a better job of estimating the CCS volumes of sequenced mail, both letters and flats. There is a problem there. It needs to be

done. As far as the third thing I'm not sure that I could come up with any one third thing.

I would like to see more work done on the new delivery cost study, but like I say on the whole I think it's a far great improvement over what we had. I'm sorry.

COMMISSIONER GOLDWAY: That's okay. I appreciate it. As I said, I knew you hadn't actually prepared this, but --

THE WITNESS: I know delivery, I don't know mail processing as well.

COMMISSIONER GOLDWAY: Thank you.

CHAIRMAN OMAS: I think that completes your testimony here today. Excuse me. I'm sorry.

Do you need some time with your witness?

MR. MCLAUGHLIN: Mr. Chairman, we have no redirect.

CHAIRMAN OMAS: Thank you.

You're excused, and we thank you for your contribution to our record today, Ms. Crowder.

(Witness excused.)

CHAIRMAN OMAS: Mr. McLaughlin?

MR. MCLAUGHLIN: We call Godfred Otuteye.

CHAIRMAN OMAS: Would you please remain standing. Can you raise your right hand?

Whereupon,

GODFRED OTUTEYE

having been duly sworn, was called as a witness and was examined and testified as follows:

DIRECT EXAMINATION

BY MR. MCLAUGHLIN:

Q Mr. Otuteye, I'm handing you two copies of a document identified as ADVO-RT-2, rebuttal testimony of Godfred Otuteye on behalf of ADVO, Inc. Was this testimony prepared by you under your direction and supervision?

A Yes, it was.

Q Is it true and correct to the best of your knowledge?

A Yes.

Q Would your testimony be the same if it were being given orally today?

A That is correct.

MR. MCLAUGHLIN: Mr. Chairman, I would ask that ADVO-RT-2 be put into evidence and included in the transcript.

CHAIRMAN OMAS: Is there any objection?

(No response.)

CHAIRMAN OMAS: Hearing none, I will direct counsel to provide the reporter with two copies of the

correct and direct testimony of Mr. -- I'm sorry.

THE WITNESS: Otuteye.

CHAIRMAN OMAS: I'm sorry, sir.

THE WITNESS: No problem.

CHAIRMAN OMAS: That testimony is received into evidence and is to be transcribed into the record.

(The document referred to, previously identified as Exhibit No. ADVO-RT-2, was received in evidence.)

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Postal Rate Commission
Submitted 9/8/2005 3:23 pm
Filing ID: 46691
Accepted 9/8/2005

ADVO-RT-2

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

POSTAL RATE AND FEE CHANGES PURSUANT TO PUBLIC LAW 108-18	:	**Docket No. R2005-1**

REBUTTAL TESTIMONY

OF

GODFRED OTUTEYE

ON BEHALF OF

ADVO, INC.

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September 8, 2005

REBUTTAL TESTIMONY OF GODFRED OTUTEYE

BIOGRAPHICAL SKETCH

My name is Godfred Otuteye, and I am the President and Chief Executive Officer of Money Mailer, LLC, and all of its affiliated companies, positions I have held since 1999. Money Mailer®, headquartered in Garden Grove, California, is the nation's second largest saturation coupon envelope distributor, behind Valpak with whom we compete directly. From 1993 to 1999, I served as Money Mailer's Chief Operating Officer.

Immediately prior to joining Money Mailer, I served as Chief Operating Officer for DATADESK International, Inc., a leading-edge keyboard and input device manufacturer. My earlier business experience includes service as Vice President/Chief Financial Officer for Micro-D, Inc. (now Ingram Micro, Inc.), the United States' largest wholesale distributor of microcomputer software and hardware accessories, later moving up the ranks to become the company's Senior Vice President/Chief Financial Officer; Chief Financial Officer for Brinderson Corporation, a project construction company; and Vice President and Senior Loan and Credit Officer with Union Bank, Los Angeles.

In addition to my duties with Money Mailer, I am also a member of the Boards of Directors of the International Franchise Association (IFA), and the Pacific Coast Regional Small Business Development Corporation (PCR), a non-profit corporation founded in 1977 to assist small business owners in becoming successful members of the Southern California business community. I am also active in the affairs of the Saturation Mailers Coalition, of which Money Mailer has been a member since the

organization's inception in 1997, and a supporting member of the Alliance of Independent Store Owners and Professionals, an organization that represents our small business customers' interest in affordable mail advertising.

My educational background includes a B.A. from Harvard University and an M.B.A. from the University of Southern California.

I previously presented testimony to the Postal Rate Commission in Docket R97-1 on behalf of the Alliance of Independent Store Owners and Professionals (AISOP-T-1).

PURPOSE OF TESTIMONY

The purpose of my testimony is to express the opposition of Money Mailer to the proposal of Valpak to increase the Enhanced Carrier Route letter-flat rate differential beyond the level proposed by the U. S. Postal Service, and to explain the adverse impact its proposal would have.

Although I oppose that aspect of Valpak's presentation, Money Mailer, and I am sure other saturation mailers, just as strongly concur with Valpak's demonstration that the cost coverage and overall rate levels for the Enhanced Carrier Route subclass are too high. Nevertheless, I do not object to the Postal Service's proposed rates in this case, but hope that these matters will be addressed in the future.

I. MONEY MAILER AND THE COUPON ENVELOPE MARKET

Since its establishment in 1979, Money Mailer's core business has been to provide small local businesses (mainly those small businesses with less than 10 employees) with an affordable and effective means of advertising and growing their

businesses through Money Mailer's saturation coupon envelope program. Currently, through our more than 275 franchisee operators (each of them a small business in its own right), we serve more than 30,000 customers in 34 states across the nation. Over 90 percent of our customers are small, locally-based businesses and entrepreneurs. In addition, we serve a number of regional and national advertisers that, although smaller in number, are important to the success of our business. This year we expect to distribute more than 150 million envelopes through the mail at ECR saturation mail rates.

In most of our markets, Money Mailer competes head-to-head with Valpak, our primary competitor. Valpak, backed by the resources of Cox Enterprises (the sixth largest media company in the nation), is by a wide margin the largest coupon envelope mailer in the nation, distributing more than 500 million envelopes annually. Money Mailer is the second largest, although our annual distribution of about 150 million envelopes is less than a third of Valpak's. The only other significant national coupon mailer is SuperCoups, a subsidiary of Advo, which distributes around 60 million envelopes annually.

There are an unknown number of smaller local and regional coupon envelope distributors, although many of them tend to specialize in niche segments of the market, such as "card deck" distributors that target affluent neighborhoods with glossy offers for high-end home remodeling projects or luxury products and services. In addition, we compete, though less directly, with magazine-format "coupon clipper" publications that are typically mailed as ECR saturation flats. For Money Mailer, our main competition is Valpak.

II. MONEY MAILER'S ENVELOPE FORMAT

When Money Mailer was launched in 1979, Valpak was already an established competitor. Money Mailer determined early on that to succeed in the marketplace, it needed to distinguish itself from its larger competitor. A key element of our competitive differentiation is the use of a larger letter format than that used by Valpak. Our letter envelope measures 9.5" x 6", compared to Valpak's 9.5" x 4.5" format, and uses a better quality (thicker) paper. In addition, we print our individual coupons on a heavier paper stock than Valpak.

These format differences offer advertisers a distinctive choice and alternative to Valpak's offerings. These differences are not costless to Money Mailer. With our larger-format coupon, we incur a higher cost for paper and printing. On top of this, however, under the ECR postal rate structure, these format differences also mean that, for a given number of coupon inserts, Money Mailer's envelopes hit the 3.3 ounce pound-rate breakpoint and the 3.5 ounce flat surcharge more quickly than Valpak's (31 pieces for Money Mailer versus 46-52 pieces for Valpak). As a result, about 40 percent of our coupon envelopes exceed 3.3 ounces and pay the pound rate, and about 23 percent exceed 3.5 ounces and pay the letter-flat rate differential as a "nonletter." By comparison, almost none of Valpak's coupon envelopes exceed the breakpoint.

III. THE LARGE LETTER-NONLETTER RATE DIFFERENTIAL IS AN OBSTACLE TO GROWTH

One of Money Mailers' key business objectives is to help its franchisees grow their business by helping them increase the average number of coupons in the coupon envelopes they mail. However, the large letter-flat rate differential, even at

its current level, is an obstacle to this growth. For an envelope weighing close to 3.5 ounces, the addition of even one more advertising coupon subjects us to a 0.8¢ per piece surcharge as a "nonletter." That surcharge, $8 per thousand coupons, can exceed the net revenue a franchisee may earn after costs for paper, printing, and sales commissions for local advertising. For national ads, sold at highly competitive prices, that additional postage cost can exceed the total net revenue we receive from those accounts for inserting and mailing their coupons

In addition to the letter-flat surcharge that kicks in at 3.5 ounces, we also must pay the "per pound" rate on all pieces over 3.3 ounces. As an example of the combined rate impact of the pound rate and the surcharge, adding just two-tenths of an ounce (two coupons) to a 3.3 ounce envelope would, under the Postal Service's proposed rates, increase our postage by more than 1.5 cents.

One way for us theoretically to avoid the surcharge, of course, would be to stop soliciting additional advertising in zones or in markets or in months where we expect our envelopes to exceed 3 ounces or so. In the real world, however, sales efforts cannot be so finely tuned to solicit "enough" advertising but not "too much" in order to avoid triggering the surcharge. It is counterproductive to tell our salespeople and franchisees to "sell, sell, sell, but not too much."

In fact, attempting to fine tune our selling to avoid the surcharge would be impossible, unless we were to abandon cross-selling between our franchisees and also concede to Valpak the market for national advertisers and even many local advertisers. Advertisers do not want to gerrymander their promotions to a "checkerboard" geography dictated by the mailer's postal pricing constraints. They

want distribution to *their* desired market areas. If Money Mailer's geographic offering *does not match the advertiser's needs, the advertiser will switch to another provider,* most likely Valpak.

IV. VALPAK'S PROPOSAL WOULD HINDER MONEY MAILER'S ABILITY TO COMPETE

This underscores a fundamental key to the success of any cooperative advertising program, whether it be coupon envelopes or shared mail or shopper publications: the ability to cross-sell across zones and markets.

To place this in perspective, our typical franchisee is a husband-and-wife team whose market area encompasses 50,000 households, divided into five zones of 10,000 addresses each. If for a given mailing date the envelope is under the pound rate breakpoint in some of these zones, the franchisee really has an incentive to sell additional advertising into the envelopes. But if these advertisers want to also cover zones where the envelope is already near 3.3 ounces, the franchisee may find he or she is working too hard to make a sale that triggers the pound rate and the flat surcharge. The franchisee's dilemma then is to accept the entire promotion and pay the substantially higher postage, or lose the customer to a competitor like Valpak.

Our pricing dilemmas are compounded when we have different franchisees wanting to do cross-sales with other franchisees in our network. Cross-selling is important to the success of any cooperative advertising program as a critical means to attract a broader segment of advertisers, particularly larger regional and national advertisers. This should be a win-win proposition for Money Mailer and the United States Postal Service. But the flat surcharge and high pound rate make it more difficult for each of our franchisees to offer competitive prices.

Other problems we face with the present pound rate and flat surcharge are the high costs associated with putting heavier advertising pieces in our envelope. Our standard coupon weighs a tenth of an ounce. This can have sufficient impact for most of our customers. But many actual and potential customers would like it if we could offer more varied ads at reasonable prices. A take-out and delivery restaurant might want to reproduce its menu. This could weigh as much as four or five coupons. If our envelope is underweight, we can do this and offer the customer a competitive price. But if this additional heavier insert would cause the envelope to go overweight and trigger the flat surcharge, or if the customer wants to cover multiple zones, we face a pricing dilemma and a competitive disadvantage.

National advertisers in particular are interested in the broadest possible geographic coverage for their messages at a competitive price. Because of Valpak's substantially larger national "footprint," covering most of the prime markets in the nation, Money Mailer starts at a competitive disadvantage in competing for this important segment of business due to our smaller size. If we were to further shrink our footprint by limiting national advertisers to a "checkerboard" pattern of zones or markets where our envelopes are below the breakpoint in order to avoid the flat surcharge, we would surely lose those advertisers to competitors who offer their entire coverage. Yet even when we do offer these advertisers our entire coverage (as we must if we want to compete for their business), the pound rate and flat surcharge place us at a competitive pricing disadvantage against Valpak.

In sum, Money Mailer does not have the luxury of tailoring our offering and restricting our sales to zones or markets where our envelopes would avoid the flat

surcharge. To do so would be to cede the business to our competitors. It would also deprive advertisers of an alternative to Valpak. More fundamentally, as a company, we want to and must grow our business and expand our customer base, objectives that we believe are critical to our viability and to our ability to compete effectively with Valpak.

V. VALPAK'S PROPOSAL SHOULD BE REJECTED

Money Mailer can live with the Postal Service's proposal to increase the letter-flat rate differential to 0.9¢ (although I believe that the combined effect of the proposed pound rate and letter-flat differential produce rates that are too high). However, Money Mailer strongly opposes Valpak's effort to further increase the letter-flat rate differential.

The irony of Valpak's proposal is that it could cause the Postal Service to lose incremental revenues from Money Mailer. Currently, for additional advertising inserts that we generate above the 3.3-ounce breakpoint, we pay the pound rate; and for envelopes above 3.5 ounces we additionally pay the letter-flat rate differential. Any substantial increase in the letter-flat surcharge would necessarily cause us to reconsider our strategy of generating new sales and inserts that might trigger the surcharge. That would not only hinder our growth, but would also deprive the Postal Service of the additional postage revenue we currently generate on these pieces.

Most importantly from our perspective, Valpak's proposal would hinder Money Mailer's ability to compete with Valpak. Although I cannot speak as to Valpak's intent, that would be the effect of its proposal.[1]

One might ask, why doesn't Money Mailer simply shrink its advertising format – downsizing to a smaller envelope and lighter coupons to emulate Valpak – as a means of reducing weight and mitigating the impact of the flat surcharge and the pound rate? My answer is simple. Money Mailer *must* differentiate itself and its program from Valpak in the marketplace in order to remain competitive. As the distant "number two" in the marketplace, we must not only "try harder," but we must also offer advertisers a distinctive alternative to Valpak. Transforming ourselves into a "little valpak" clone, but without Valpak's strong market penetration and corporate resources, would, in my opinion, be folly.

Valpak may try to contend that, in this rate case, its intention is not to increase rates for ECR non-letters but merely to reduce the rate for ECR letters weighing less than 3.5 ounces. It does not matter to me whether Valpak intends to implement its proposal by increasing the rate for saturation flats, or by reducing the rate for saturation letters, or by some combination of the two. In any case, its proposal would further increase the spread between the effective postal rate we pay versus our main competitor. And in any case, its proposal would place us at a further competitive pricing disadvantage. Moreover, it is abundantly clear from the

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[1] Surprisingly, Valpak's two witnesses in this case professed little knowledge of the coupon envelope marketplace. I am certain, however, that at the Valpak corporate level, Valpak is well aware of these marketplace realities, and is keenly aware that its proposals will enhance its competitive advantages over its closest rival in the coupon envelope distribution business.

testimony of Valpak witness Mitchell that Valpak intends to press in the future for an *even bigger rate spread by imposing a punitive pricing* "markup" on the letter-flat cost differential, just as in the past it has vigorously opposed proposals to reduce the high ECR pound rate.

V. SATURATION POSTAL RATES SHOULD PROMOTE HEALTHY COMPETITION

Although Money Mailer's primary concern with Valpak's proposal is its adverse impact on our ability to compete effectively, we have always taken a broader view of the saturation mail industry. Saturation mailers of every ilk are, in widely varying degrees, actual or potential competitors of each other. Nevertheless, I firmly believe that we all share a common interest in preserving saturation mail as an affordable and viable medium for the millions of businesses and entrepreneurs, big and small, that depend on saturation distribution of their advertisements to consumers in their local market areas. Healthy competition within a healthy industry is good for us all, forcing each of us to stay on our toes and improve our products and services. It is also especially important to our advertising customers, giving them a broader choice of advertising products at competitive prices – an environment that ultimately benefits the end consumers: the American public.

Money Mailer itself competes not only with Valpak but to a less direct extent with Advo, other shared mailers, and shopper publications for a slice of the saturation mail market. A good example is pizza establishments, both local "mom and pop" and particularly national pizza chains. Each of us competitors offers a distinctive advertising vehicle for these businesses, and it is our business to convince these potential customers that our particular product, or combinations of

advertising programs through multiple saturation providers, makes sense for their businesses.

This competition, and the choices advertisers make among mail providers, should be decided primarily in the marketplace, not in the Postal Rate Commission's hearing room. In the postal rate arena, Money Mailer could attempt to propose a rate structure that was particularly suited to its business and to the disadvantage of our various competitors. While that might be in our short-term interest, I am not convinced that it would be in the interest of a healthy and viable saturation mail industry or the U. S. Postal Service. Nor for that matter would it be in the interest of advertisers that want competitive choices, or ultimately the consuming public. I urge the Commission to reject Valpak's proposal to increase the letter-nonletter rate differential.

SHARP

JOTICE PAGE

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\# 12 Sep 2005 12:19:18

\# Username unknown

\# Jobname unknown

(*)Your entered account code is not registered,

however printing was completed.

Consult your key operator for registration of account code.

CHAIRMAN OMAS: This brings us to oral cross-examination. One party has requested oral cross, that being Valpak Direct Marketing Systems, Incorporated and Valpak Direct Dealers Association, Incorporated, Mr. Olson.

Is there any other person who wishes to cross examine this witness?

(No response.)

CHAIRMAN OMAS: There being none, Mr. Olson, you may begin, please.

MR. OLSON: Thank you, Mr. Chairman.

CROSS-EXAMINATION

BY MR. OLSON:

Q Mr. Otuteye, we know you're under time constraints and I'm sure we wouldn't have any problem honoring your return flight tonight. I want to begin, this is a good sign, and ask you to turn to the last page of your testimony. The beginning of the paragraph beginning on line 3, do you see that?

A Yes, I do.

Q It says this competition, and the choices advertisers make among mail providers, should be decided primarily in the marketplace not in the postal rate commissions hearing room. Let me just take out if I can of that sentence the clause that's offset by

commas and put the rest of the sentence together and see if that works.

This competition should be decided primarily in the marketplace not in the postal rate commission's hearing room. I'm trying to understand the context of postal rates, what it means for a competition to be decided in the marketplace.

A We compete against Valpak in the marketplace. That means that we let the customers make the decisions, and decisions that we all make concerning what kind of product we're going to put out, how we produce it, what quality paper we print on. All these decisions are influenced by what is appealing to the advertisers who purchase these services from us.

The advertisers who are our customers constitute the marketplace together with the consumers who receive the envelopes at home. So we try to produce products that are appealing to both the advertisers and the consumers. That is the marketplace that I was referring to as opposed to this process here, which is not the marketplace.

Q So are you saying that you don't like the concept of an adversarial hearing where ADVO has a witness, and Valpak has a witness, and we put on

testimony and cross-examine each other's witness? Do you think that process doesn't lead us to proper rates?

A I think it can. I think it is a process that has been used for a long time. I think what is going on here, what I'm objecting to in the proposal by your client, Valpak, is the fact that they want to increase the rate differential between letters and flats. The letter flats are a great differential.

They want to increase it, which in my view I think through any logical process puts us at a competitive disadvantage relative to Valpak in the sense that the gap between what we pay for postage and what they pay for postage will be increasing, and so far I have not been given any basis for why that should be.

Q You are the president and chief executive officer of Money Mailer, correct?

A That is correct.

Q You view Valpak as being your principal marketplace competitor, correct?

A That is correct.

Q So if it's good for Valpak it's bad for Money Mailer?

A That is not correct. Not necessarily. If

tomorrow say if our prices were to drop 50 percent that would be good for Valpak and be good for Money Mailer. That's just one example where it is not true that if it is good for Valpak it has to be bad for Money Mailer.

Q Well, it's more thinking of postal rates. We do have letters, and flats and different rates for them. Do you think there ought not to be different rates for letters and flats for example?

A No. I did not say that. To the extent that the postal service has different costs for other letters and flats I accept that there can be a cost difference between them. I think, again, what I'm objecting to in my testimony is the proposal by Valpak to increase that rate differential between letters and flats.

Q What is your specific objection to? Is it to the rate at the basic level, the saturation level, the high-density level, all levels, changing any pass-throughs? Is it the cost? Are you complaining about rate design costing?

A Well, I'm not exactly sure of what your client's position is on this matter here. I'm not very sure that has been made very, very clear. Again, what I'm objecting to is that if -- I think the U.S.

postal office has proposed that all rates would go up 5.4 percent across the board.

I believe that you are objecting to that proposal on the grounds that you'd like to see the rate differential between flats and letters be increased and that is what I'm objecting to.

I do not like my prices going up, but I'm willing to live with the 5.4 percent across the board increase so that the relative difference between what we pay for our postage today and what our major competitor pays for postage remains about the same versus what I think Valpak is proposing, which would increase that differential and put my company at a significant competitive disadvantage, that is what I'm objecting to.

Q You said a second ago that you didn't mind cost-based rates. You were willing to live with that I believe. Is that correct?

A That is correct.

Q So if the reason for setting rates at a particular level is to make them more cost-based that would not bother you, correct?

A As long as somebody can demonstrate to me that those cost differences do exist. So far I have had no evidence that there is any factual basis for

the rate differential to be increased from what it has been in the past.

Q If you were persuaded there were cost-based reasons to charge differential rates then you would live with that as a competitor?

A If I can be persuaded of that, yes, I would --

Q Can you turn to page 6 of your testimony, please? The envelope is under the pound rate breakpoint. In some of these zones the franchisee really has an incentive to sell additional advertising in the envelopes, correct?

A That's correct.

Q I want to focus on the phrase *the franchisee really has an incentive*. I assume the reason that a franchisee really has an incentive if you're under the breakpoint is that you can add weight to the envelope without paying any additional postage, correct?

A That is correct.

Q So if you had a two and a half ounce piece for example of Money Mailer envelope you could add two coupons and your paper costs, and printing costs will increase and maybe handling costs would increase a little bit, too, I guess, but your revenue is going to go up and your customers will receive value, but the

postal service won't get any additional postage for those two pieces?

A I think that statement is correct, but I do not like the implication. We pay a fixed price for postage up to 3.3 ounces, and so it's like if you pay rent at $1,000 a month for an apartment and you only live in the bathroom I think you are wasting a lot of your money. You are not taking advantage of what you paid for.

So I think the franchisee selling additional ads to consume the postage you have already paid is a totally rational exercise.

Q No. I'm not saying it isn't rational, but if you're at two and a half ounces and you add a couple of pieces to it you are getting additional revenue without paying additional money to the postal service. I mean, that's clear isn't it?

A That is correct.

Q If you add two more pieces you still gain additional revenue. I'm sure four pieces don't get you up to an ounce or up to the breakpoint of 3.3 ounces. I don't know what the math is, but if you keep adding, and then all of a sudden you get to 3.3 ounces, and then you add a couple of more pieces and you go over the breakpoint at that point, you -- you

still have to pay a little more postage because if it is an automatable piece as -- and I don't know if you pay the heavy weight rate or not, between 3.3 and 3.5 ounces?

A The postage goes up after you pass 3.3 ounces; that is correct.

Q So it is a little more -- a little bit of a pound rate, correct?

A I would not characterize this as a little bit. It is extra postage, and you pay more postage when it goes above 3.3 ounces.

Q Okay. Well, I guess what I am saying is when you keep adding pieces up to the break point, you are happy to have that happen. And then when you get over the break point, even though you are earning more revenues, that bothers you. I take it that you would like to have a very high break point. Would that help?

A Here is the point. You are out there working, and you are paying additional postage for it. There are times when the additional postage that we pay causes problems.

It makes it very difficult to price your business. There is business that we miss because of the additional postage above 3.3 ounces. There are

customers who want to get in our envelope that we cannot service because of the extra postage.

So it is not a -- it is a relevant issue. It does affect our business.

Q But when the Commission hears a case like this, and they issue an opinion and recommend a decision, and they urge the Postal Service or authorize the Postal Service to implement a set of rates, that set of rates is available to all mailers is it not?

A That is correct.

Q Okay. So Val Pak has chosen to configure its operations for whatever reason, and take advantage of the rates in one way, and you have chosen a different way, correct?

A Right.

Q And would you concede that there may actually be other mailers out there in the industry that do things even differently than Val Pak and Money Mailer?

A That is correct.

Q Okay. So if -- I mean, I am just thinking. You say in your testimony that you have chosen to compete with Val Pak by going to a larger format and a heavier stock of the coupon; isn't that correct?

A That is correct.

Q And -- I mean, there could be other coupon mailers that come along, and they said that we are going to do the opposite. We are going to have a lightweight -- a lighter weight piece of paper. We are going to have a smaller sheet of paper, a 3-by-5-card size.

And they would decide to take advantage of the Postal Service's rate schedule in a different way, and that could happen could it not?

A Yes, it can.

Q Okay. And if Money Mailer has this bigger format -- I mean, I am certain that there are some benefit to it if I were selling -- I used to sell encyclopedias. I don't usually admit that.

If I were selling it, I would say go with Money Mailer. We have a bigger format, and you can put more information on there, and have nicer graphics. I mean, isn't that part of the sales approach for Money Mailer?

A Absolutely it is.

Q So there are benefits to Money Mailer having the format that you have chosen?

A Yes.

Q And I guess what I am getting at is that if

there are different competitors in the same industry, and they choose to use the Postal Service's rates in different ways -- some are all lightweight, and some are -- some are both, and some are all heavyweight. I mean, isn't that just part of life that they have chosen to do that?

And that you wouldn't want the Commission looking at rates, and saying, well, this mailer is going to be helped, and this one is going to be hurt, and we like that mailer more than that mailer, and we are going to structure them so that this company can compete and grow bigger, and this one wouldn't be so big? That's not really what you want is it?

A I am willing -- my company is willing to live the economic decisions that we have made to compete in the marketplace. I think that it is in fact my view that Val Pak is doing exactly what you just described.

I think that they are the ones who have come to the Commission to say we would like to set this rate to favor us relative to our competition. They are the ones who are saying increase the flat letter differential.

Why? Because their envelopes are generally under the 3.3 ounce weight limit, and so therefore, if

they get away with this, they are going to be paying significantly less postage than the rest of us in the sense that they have fewer pieces that ever go beyond 3.3 ounces.

So I am not the one here saying that something should be structured specifically for our company. I think if anything that the shoe is on the other foot.

Q So you -- a moment ago, you said that Val Pak was coming in and saying that the Commission should do things for the benefit of Val Pak, and I wonder, have you read either Dr. Haldi's or Mr. Mitchell's testimony in this case?

A I have been briefed on their testimony.

Q You have not read either?

A No, I have not.

Q When I look at your testimony, I see a heavy emphasis on this issue of competition. That is a major reason that you are here today, right; is the ability -- is preserving the ability to compete?

A That is correct.

Q Okay. And I look at your testimony at page 9, line 1, and you say most importantly is Money Mailer's ability to compete with Val Pak. And then on that say page, on line 17, you say that the postal

rate -- the key thing is the postal rage that we pay, versus our main competitor, Val Pak.

And on page 8, or the page before -- and I don't want to go too fast, but on line 18, you say that this would hinder our growth if Val Pak -- if their proposals are adopted.

And then on page 10, line 7, you say that it would impact our ability to compete. I mean, those are the reasons that you want a low letter flat rate differential, correct?

A I would like the differential to stay about what it is now.

Q Okay. At the end of your testimony, you -- well, back where we started, there is a sentence that says that in the postal arena, Money Mailer -- and this on line 5 --

A On what page?

Q Page 11.

A Okay.

Q It says that in the postal rate arena, Money Mailer could attempt to propose a rate structure that was particularly suited to its business and the disadvantage of our various competitors.

Your position is, is it not, that you want the across-the-board. That that seems fair and that

allows you to compete better?

A I do not like paying 5.4 percent more postage, but I am willing to live with it, and to accept it, because it retains the relevant difference the postage that we pay and what Val Pak pays today.

If you increase the rate differential, then that puts us at a competitive disadvantage, and that is what I am objecting to.

Q One of the things that Val Pak has done in this docket, and I will represent this to you because I know that you have not read the testimony, but maybe in the briefing that you received on it, is that Val Pak tried to introduce evidence about the way in which -- since R2001-1 and before, all the costs of detached address labels for city carrier and rural carrier costs have been paid by -- erroneously paid by letters, not flats. It was a mistake and is being fixed.

And then the question became how many DALs are there, because we need to back those costs out. So Val Pak put in testimony about the proper number of DALs. Are these things that you object to also; that trying to improve the costs, and trying to have better rate design?

I am just wondering if it is everything that

Val Pak has done that is problematic?

A I am not a postal rate expert. I do not understand the esoterics of how postal rate costs are determined. I think that others who are more qualified than me in that regard -- Toni Crowder, who is a witness in this, have presented testimony disputing or rebutting Val Pak's position on this.

And I would defer to their position on this than any comments that I can make specifically on that.

MR. OLSON: All right. Thank you so much, sir. I appreciate you coming in and answering these questions. And thank you, Mr. Chairman.

CHAIRMAN OMAS: Thank you. Is there any follow-up cross-examination?

MR. MCLAUGHLIN: No, Mr. Chairman.

CHAIRMAN OMAS: All right. Do you need some time with your witness, Mr. McLaughlin?

MR. MCLAUGHLIN: No, I don't.

CHAIRMAN OMAS: Are there any questions from the bench? Excuse me, I'm sorry. I jumped the gun. Commissioner Goldway.

COMMISSIONER GOLDWAY: Yes. Welcome. I have another Californian here in the hearing room with me. I think that I understand your interest in

maintaining the existing rate relationship between yourself and your competitor, and that for you in the world that you are operating in that seems to work.

Our job as Commissioners is to assure that the Postal Service itself operates efficiently, or as efficiently as possible. If it turns out, if we can ever find out, that the costs for different operations of the mail are dramatically different from the costs that we are now using to base rates, and that by establishing certain rates we are subsidizing certain classes of mail, or encouraging certain inefficiencies in other kinds of mail, shouldn't we make the effort to change that even if it might alter the competitive relationship that you have?

What is our responsibility in this and do you have a point of view on that?

THE WITNESS: I think so. If I am persuaded objectively that there is the cost difference -- and I think that is the basis of the Postal Service's pricing today based on the knowledge that has been established on the cost differences in the different classes of mail, then yes.

If the Post Office undertakes a study that approves that certain classes of mail cost certain amounts, then I don't have an objection to paying a

proper rate for the class of service that I am receiving. My objection to what a major competitor has put forth is that I don't believe that such a cost differential has been established.

COMMISSIONER GOLDWAY: You do mention in your testimony that you wouldn't mind seeing some adjustment in the overall --

THE WITNESS: ECR rate.

COMMISSIONER GOLDWAY: -- ECR -- well, coverage rates in the future.

THE WITNESS: Right.

COMMISSIONER GOLDWAY: Now, if we did that, it might cause a big rate shock for people who are non-ECR mailers, and they would say perhaps that that is unfair competition; that we are favoring one side or another.

I mean, we will come up against this at any time, and you so you recognize the responsibility that we have at certain points to make decisions that look unfair to one party, but from our point of view of making the Postal Service more efficient, it seemed responsible to us?

THE WITNESS: I understand that. I understand that different parties come in here to fight for what they believe is right for their point

of view. In this particular instance again, the issue here is this. We compete with our major competitor in a variety of different ways.

It is not just the product that is different. We service different segments of the market. We tend to focus on the mom and pop operators. Very small businesses. Val Pak tends to get after the larger accounts in the marketplace.

That affects our costs in different ways, and so in answer to your question, I don't believe that right now what they are proposing to you -- I think that would put us at a disadvantage, and I am not convinced that there is a solid basis for them to have that, and for there to be special treatment.

COMMISSIONER GOLDWAY: I appreciate that. Thank you.

CHAIRMAN OMAS: Thank you, Commissioner Goldway. Are there any additional questions for the witness?

(No response.)

CHAIRMAN OMAS: There being none, Mr. Otuteye, that completes your testimony here today, and we appreciate your appearance and your contribution to our record, and you are now excused.

THE WITNESS: Thank you, Mr. Chairman.

(Witness excused.)

CHAIRMAN OMAS: This concludes today's hearings. We will reconvene tomorrow morning at 9:30, where we will receive testimony from Postal Service witnesses' Kiefer, Lewis, and Bradley. Thank you very much. See you in the morning.

(Whereupon, at 2:53 p.m., the hearing was adjourned, to reconvene at 9:30 a.m., on Thursday, September 15, 2005.)

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REPORTER'S CERTIFICATE

DOCKET NO.: R2005-1

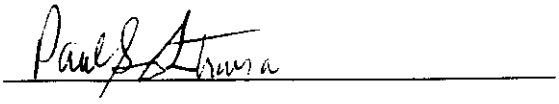
CASE TITLE: Postal Rate and Fee Change

HEARING DATE: September 14, 2005

LOCATION: Washington, D.C.

I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the Postal Rate Commission.

Date: September 14, 2005



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